

(Broad Guidance and information on expectations from Auditors in Bank Audit)

Bank audit appointments now contain a stipulation that auditors need to report to the Chairman of the Bank and in cases of amounts above Rs. 100 lacs, also to the RBI on matters which susceptible to frauds, fraudulent activity etc.

1. ATTENTION IS DRAWN TO THE REQUIREMENTS OF THE RESERVE BANK OF INDIA AS REGARDS CLASSIFICATION AND REPORTING ON FRAUDS, WHICH BROADLY DEALS WITH:

A. CLASSIFICATION OF FRAUDS (based mainly on the provisions of the Indian Penal Code)

In order to have uniformity in reporting, frauds have been classified as under based mainly on the provisions of the Indian Penal Code:

- (a) Misappropriation and criminal breach of trust.
- (b) Fraudulent encashment through forged instruments, manipulation of books of account or through fictitious accounts and conversion of property.
- (c) Unauthorised credit facilities extended for reward or for illegal gratification.
- (d) Negligence and cash shortages.
- (e) Cheating and forgery.
- (f) Irregularities in foreign exchange transactions.
- (g) Any other type of fraud not coming under the specific heads as above.

B. REPORTING OF FRAUDS TO RBI

- Frauds involving Rs.1 lac and above
- Frauds committed by unscrupulous borrowers
- Frauds involving Rs.100 lacs and above
- Cases of attempted frauds

C. QUARTERLY RETURNS

- Reporting on Frauds outstanding
- Progress report on frauds

D. REPORTS TO THE BOARD

- Reporting of frauds
- Quarterly review of fraud cases
- Annual review of fraud cases

E. GUIDELINES FOR REPORTING OF FRAUDS TO POLICE/CBI

**F. REPORTING (CASES OF THEFT, BURGLARY, DECOITY AND BANK ROBBERIES)
(Formats are prescribed for each)**

Reporting to RBI is to be the responsibility of an official of the rank of General Manager, the reports to be as per the software on FRAUDS REPORTING AND MONITORING SYSTEM.

2. Auditors should refer also to Chapter 29 of the 2008 edition of the Guidance Note on Audit of Banks; as also the latest Circulars of the RBI, covered by the appointment letters issued (with the modified scope of work since the year 2003) and the original appointment letters containing this stipulation.

3. SCOPE OF WORK NOW COVERS REPORTING ON:

ANYTHING SUSCEPTIBLE TO FRAUD
FRAUDULENT ACTIVITY
ACT OF EXCESS POWER
'SMELL FOUL' PLAY IN ANY TRANSACTION

(Broad Guidance and information on expectations from Auditors in Bank Audit)**4. ATTENTION IS DRAWN TO AAS 4 (REVISED)**

WHICH BRINGS OUT THE DISTINCTION BETWEEN FRAUD AND ERROR (PARA 2)
INTENTIONAL Vs UNINTENTIONAL

5. AREAS OF CONCERN FOR THE AUDITORS/SUGGESTIONS**WILL INVOLVE LOOKING INTO IN DEPTH****a) INTERNAL CONTROL SYSTEMS AND PROCEDURES**

-ABSENCE

-INADEQUACY

-BREACH OF

AND WILL REQUIRE THE AUDITORS TO ENQUIRE (PREFERABLY IN WRITING) INTO ANY MATTERS PENDING IN VIGILANCE, INTERNAL ENQUIRY INVOLVING MISDEMEANOUR IN TRANSACTIONS OR EVENTS AND TO DOCUMENT THIS

Attention is drawn to Para 5.3.2 of the RBI Circular dated 25-7-2006 dealing with the Bank's Annual Review of Frauds which, inter alia, also focus on the systems aspects as under :

- Whether the systems in the bank are adequate to detect frauds, once they have taken place, within the shortest possible time.
- Whether frauds have taken place because of laxity in following the systems and procedures and, if so, whether effective action has been taken to ensure that the systems and procedures are scrupulously followed by the staff concerned.

b) RISKS ATTACHED TO EXTENSIVE USE OF NOMINAL HEADS

- with old, large outstandings, which cannot be ignored

c) DELINQUENCY IN CUSTODY AND CONTROL OVER CRITICAL/SECURITY PAPER STATIONERY

/ NUMBERED FORMS (CHEQUE BOOKS, WITHDRAWAL SLIPS, PAY ORDERS, BANKER'S CHEQUES, DDs
 TTs MTs)

d) UNRECORDED CONTINGENT LIABILITIES/OBLIGATIONS AND OFF BALANCE SHEET EXPOSURES

(Letters of Comfort, if in vogue, and not recorded in the Registers)

e) UNSUBSTANTIATED DEBITS

=IN INOPERATIVE ACCOUNTS OR THOSE EXPECTED TO BE FROZEN AT BRANCH LEVEL..

=AGAINST OLD BALANCES PICKED UP FROM MANUALLY MAINTAINED ACCOUNTS UPON SWITCH OVER TO COMPUTERISATION

=AGAINST CREATION OF WRONGFUL CREDITS for potential misuse

f) LOSS OF CONTROL OVER CREDITS COMPRISING TERM DEPOSITS

(FOREX/ RUPEE)..CONSEQUENT UPON AUTOMATIC RENEWALS ON MATURITY OF OLD DEPOSITS

Banks appear to have lost control over these

=THERE ARE DEPOSIT RECEIPTS IN THE PHYSICAL POSSESSION OF BRANCHES(without dual control)

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=ADJUSTMENT ENTRIES MADE (IN BOOKS), ON MATURITY DATES WITHOUT ISSUANCE OF RECEIPTS, AS PART OF THE COMPUTERISED SYSTEM
 =RENEWALS BY ENDORSEMENTS ON THE INVERSE OF OLD RECEIPTS WITH INADEQUATE RECORDING.

g) DELINQUENCY IN OPENING OF NEW DEPOSIT ACCOUNTS
 (without observing "Know your customer" norms)

h) Unreconciled Merchant Deposit Accounts

i) INTER BRANCH - ARREARS OF MATCHING/RECONCILIATION OF ENTRIES

(Old/unexplained and other entries over six months old in various nominal heads at the Branch level)

j) UNLINKED DEBITS IN BILLS PAYABLE, BANKER'S CHEQUES AND SIMILAR INSTRUMENTS

(such instruments being in physical custody of the bank officials invite a risk of misuse)

k) ADVANCES TO WILFUL DEFAULTERS ON THE LIST OF RBI

(Reasons for Quick mortality in advances, say within 12-24 months of sanction should also be enquired and, these will indicate lapses in (appraisal)

l) EVERGREENING OF ACCOUNTS ON FREQUENT BASIS

(REHABILITATION/REPHASEMENTS/RESTRUCTURING/RESCHEDULING /FREQUENT EXCESS, AD HOCS)

WCT/FITL/WCDL ACCOUNTS ARE CLEAR INDICATIVE OF THESE, as these arise out of defaults in servicing of debts

m) INAPPROPRIATE COMPUTATION OF DP in advances against stocks contrary to RBI directives, leading to higher limits not warranted as per norms, i.e., without deduction of unpaid for stocks comprised in Sundry Creditors

n) NON UPDATION OF RECORDS LIKE

=UNAPPLIED INTEREST in NPAs,

=RIGHT OF RECOMPENSE in accounts restructured/rehabilitated conditionally,

THEREBY RISKING LOSS OF POTENTIAL INCOME WHILE UPGRADING OR RECOVERING THE ADVANCE ... EVEN ON SETTLEMENT CASES IN WRITE OFF/PRUDENTIAL WRITE OFF (ALSO NON-RECORDING OF THE WAIVER OF UNAPPLIED INTEREST/POTENTIAL INCOME)

o) LARGE CASH TRANSACTIONS (above Rs.10 lakhs), AND THOSE UNUSUAL IN NATURE, unreported;

or those not permitted (e.g. Bank Drafts over Rs.50000 against cash),

(would require review of Daily Exceptional Reports generated in the EDP Environment)

These could also be correlated to the BCTT returns/statements, also based on information on tax collected

p) LOSS OF AUDIT TRAIL DUE TO NON PRINTING OF THE BOOKS OR IN FILING OF LEDGERS MONTH-WISE AND NOT HEAD-WISE.

q) NON/DELAYED COMPLIANCE OF INSPECTION AND OTHER REPORTS

(SYSTEM AUDIT DEFICIENCIES IGNORED/NOT REMEDIED) AND BASIC CONCEPTS IGNORED e.g. DISTINCTION NOT MAINTAINED BETWEEN INTEREST ACCRUED AND DUE/NOT DUE

(e.g., FCNR B INTEREST ACCRUES BUT IS NOT DUE ON 2-5 YEAR DEPOSITS; ON SAVINGS BANK ACCOUNTS IT IS DUE BUT NOT APPLIED)

(Broad Guidance and information on expectations from Auditors in Bank Audit)**r) NON VERIFICATION OF CURRENCY CHEST BALANCES BY BANK, LEADING TO CLAIMS ON THE BANK BY RBI, FOR SHORTAGES, FORGERIES AND FRAUDS****6. EXTENSIVE COMPUTERISATION (AND BUNDLE OF RISKS ATTACHED)**

- OLD OUTSTANDINGS PICKED UP FROM MANUAL RECORDS, REMAINING UNADJUSTED
- DOUBLE DEBITS FOR THE SAME TRANSACTION IN MANUALLY MAINTAINED ACCOUNTS AND COMPUTERISED ACCOUNTS ON MIGRATION TO EDP ENVIRONMENT
- SECURITY SYSTEMS NOT IN PLACE FOR HARDWARE/SOFTWARE
- NON ROTATION OF STAFF DUTIES
- BACK UPS/ OFF SITE STORAGE ... SYSTEMS NOT IN FORCE OR NOT TESTED
- EXCEPTIONAL REPORTS TAKEN LIGHTLY
- PRINT OUTS NOT TAKEN OF THE BOOKS REGULARLY/HARD COPIES NOT FILED PROPERLY
- **EFFECTIVE DATES NOT OBSERVED FOR CHANGES IN THE SYSTEM/SOFTWARE....** e.g. CHANGES IN INTEREST RATES

7. FRAUDS IN HOUSING FINANCE

(Refer THE INITIAL circular UBD No. BPD.15/12.05.01/2004-05 dated 1-9-2004)

This lists out the type of frauds that have taken place as per the report of the Committee on Frauds in Housing Finance, as under:

1. Fabrication of income documents (Income tax return/salary slips/balance sheet)
2. Loans disbursed (cheques/drafts) by banks are encashed by third parties/agents
3. Title documents being forged – stamped documents forged by borrower Customer/builder
4. Over valuation of the property
5. Multiple financing
6. Cancellation of booking of flats/property by collusion
7. Sale of property by loanee without clearing the loan
8. Misrepresentation of end use of the loan
9. Sale of the property by builder without clearing/repaying construction funding loan availed from the bank/housing finance companies

FRAUDS IN NON RESIDENT ACCOUNTS