

# FRAUD DETECTION AND CRITICAL ISSUES

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# What is Fraud?

- ▶ Act of Intentional deception or dishonesty
- ▶ Perpetrated by one or more individuals
- ▶ Generally for Financial Gains

# Elements of Fraud

- ▶ Statement must be false
- ▶ Individual must know that the statement is false
- ▶ Intent to deceive the victim
- ▶ Victim relied on the statement
- ▶ Victim is financially injured or otherwise

# Fraud in the context of bank audit

RBI Circular on Frauds–Classification and Reporting.

[CIRCULAR ON FRAUDS.PDF](#)

# Classification of Frauds

- ▶ As per Para 2 of the circular
- ▶ Based on Indian Penal Code
- ▶ Misappropriation and criminal breach of trust
- ▶ Fraudulent encashment through forged instruments, manipulation of books of account or through fictitious accounts and conversion of property.

- ▶ Unauthorised credit facilities extended for reward or for illegal gratification.
- ▶ Negligence and cash shortages if intention to cheat/ defraud is suspected/proved.
- ▶ Cheating and forgery.
- ▶ Irregularities in foreign exchange transactions.

# Role of Auditors

- ▶ Para 11.6 of the Master Circular
- ▶ Auditor should immediately bring to the notice of the management of the possibility of fraudulent transactions in the account.
- ▶ Reporting in LFAR regarding occurrence of Fraud

# RED FLAGS/ Early Warning Signals

- ▶ Request received from the borrower to postpone the inspection of the godown for flimsy reasons.
- ▶ Delay observed in payment of outstanding dues.
- ▶ Financing the unit far away from the branch.
- ▶ Frequent invocation of BGs and devolvment of LCs.
- ▶ Funding of the interest by sanctioning additional facilities.



# RED FLAGS/ Early Warning Signals

- ▶ Critical issues highlighted in the stock audit report.
- ▶ Heavy cash withdrawal in loan accounts.
- ▶ Significant movements in inventory, disproportionately higher than the growth in turnover.
- ▶ Non submission of original bills.

# Checking of NPA and Overdues

# NPA AND OVERDUE

- ▶ NPA: An asset, including a leased asset, becomes non performing when it ceases to generate income for the bank
- ▶ Overdue: Any amount due to the bank under any credit facility is 'overdue' if it is not paid on the due date fixed by the bank

# OUT OF ORDER

1. Outstanding balance remains continuously in excess of the sanctioned limit/drawing power
2. Outstanding balance is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days or credits are not enough to cover the interest debited during the same period

# NPA – 90 DAYS DELINQUENCY

- ▶ **Term Loan:** Interest and/or instalment of principal remain overdue
- ▶ **CC/OD:** Account remains Out of Order
- ▶ **Bills:** Bill remains overdue
- ▶ **Bank Guarantee:** In case Bank Guarantee is invoked and the amount remains unpaid

# NPA – 90 DAYS DELINQUENCY

- ▶ **Letter of Credit:** In case Letter of Credit is devolved and the amount remains unpaid
- ▶ **Short duration crops:** Instalment of principal or interest thereon remains overdue for two crop seasons
- ▶ **Long duration crops:** Instalment of principal or interest thereon remains overdue for one crop season

# NPA – 90 DAYS DELINQUENCY

- ▶ Working Capital Accounts:
  - Drawing power calculated from stock statements older than three months, would be deemed as irregular
  - Account will become NPA if such irregular drawings are permitted in the account for a continuous period of 90 days
- ▶ An account where the regular/ad hoc credit limits have not been reviewed/renewed within 180 days from the due date/date of ad hoc sanction will be treated as NPA

# Relaxations to MSME by RBI from 90 days delinquency Norms



# Important RBI Circulars

- ▶ Circular No. RBI/2017-18/129 DBR no. BP.BC.100/21.04.048/2017-18 dated 07/02/2018  
[circular MSME GST registered 07.02.18.PDF](#)
- ▶ Circular No. RBI/2017-18/186 DBR no. BP.BC.108/21.04.048/2017-18 dated 06/06/2018  
[NPA relief MSME June 6 2018.PDF](#)
- ▶ Circular No. RBI/2019-20/160 DOR No. BP.BC.34/21.04.048/2019-20 dated February 11, 2020.  
[msme RESTRUCTURING 11.02.2020.PDF](#)

# Salient Features of June 6 2018 notification

- ▶ Banks allowed to temporarily classify their exposure as per the 180 days *past due* criterion to all MSMEs whether GST registered or not subject to following conditions.
- ▶ A) Aggregate exposure incl Non Fund Based facilities of bank to borrower does not exceed 25 crores as on 31/05/2018.
- ▶ B) Account should be standard as on 31<sup>st</sup> August 2017
- ▶ C) Payments due from borrower as on 01/09/2017 and falling due thereafter upto 31/12/2018 were/are paid within 180 days from original due date.

# Classification norms for dues payable from January 1, 2019

- ▶ 180 days past due criteria to be aligned to extant IRAC norms in phased manner.
- ▶ [NPA relief MSME June 6 2018.PDF](#)
- ▶ Immediately revert to extant IRAC norms.

BORROWERS REGISTERED  
UNDER GST AS ON 31/12/2018

BORROWERS NOT REGISTERED  
UNDER GST AS ON 31/12/2018

- ▶ Provision of 5% shall be made by the bank for exposure not classified as NPA in terms of this circular.
- ▶ **If the interest from the borrower is overdue for more than 90 days, same shall not be recognized on accrual basis.**

# INCOME RECOGNITION

- ▶ Income from NPA is not recognised on accrual basis but is booked as income only when it is actually received.
- ▶ If any advance, becomes NPA, the entire interest accrued and credited to income account in the past periods, should be reversed if the same is not realised.
- ▶ Banks should adopt an accounting principle for appropriation of recoveries in NPAs and exercise the right of appropriation of recoveries in a uniform and consistent manner.

# ASSET CLASSIFICATION

- ▶ **Substandard Asset:** Which has remained NPA for a period less than or equal to 12 months.
- ▶ **Doubtful Asset:** Which has remained in the substandard category for a period of 12 months.
- ▶ **Loss Asset:** Where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly.

# EROSION IN VALUE OF SECURITY

- ▶ If realisable value of the security is less than 50% of the value assessed by the bank or accepted by RBI at the time of last inspection. Such NPAs may be straightaway classified under doubtful category.
- ▶ If the realisable value of the security, as assessed by the bank/approved valuer/RBI is less than 10% of the outstanding in the borrowal accounts, asset should be straightaway classified as loss asset.

# Asset Classification–Other Norms

- ▶ Advances against Term Deposit, NSCs, KVPs, & Life Policies need not be treated as NPAs, provided adequate margin is available.
- ▶ The credit facilities backed by guarantee of the Central Government through overdue may be treated as NPA only when the Government repudiates its guarantee when invoked.
- ▶ State Government guaranteed advances would attract asset classification and provisioning norms if interest and/or any other amount due to the bank remains overdue for more than 90 days.



# Upgradations

- ▶ Entire overdues till date needs to be cleared
- ▶ Partial recovery of overdues will not amount to upgradation

# Provisioning Norms

- ▶ Loss Assets: 100% of the outstanding

- ▶ Doubtful Assets:

Period	Provision Requirement (%)	
	Secured Portion	Unsecured Portion
Up to one year	25	100
One to three years	40	100
> three years	100	100

In case of NPAs with balance of Rs. 5 crore and above stock audit at annual intervals by external agencies

# Provisioning Norms

## ▶ Sub-Standard Assets:

- 1) A general provision of 15% has to be made on the total outstanding of the substandard asset
- 2) In case of unsecured exposure, which has been identified as substandard, an additional provision of 10% is to be done i.e. 25% of the outstanding balance
- 3) Unsecured exposure is an exposure where the realisable value of the security is not more than 10 percent, *ab-initio*, of the outstanding exposure

# Provisioning Norms

## ▶ Standard Assets:

- Direct advances to agricultural and SME sectors (Micro & Small) - 0.25 %
- Advances to Commercial Real Estate (CRE) - 1.00%
- Advances to Commercial Real Estate - Residential Housing Sector (CRE-RH) - 0.75%
- All other loans and advances not included in (1) and (2) above - 0.40%
- Housing Loans at Teaser rates - 2%

# Provisioning Coverage Ratio

- ▶ Provisioning Coverage Ratio (PCR) is the ratio of provisioning to gross NPA.
- ▶ It indicates the extent of funds a bank has kept aside to cover loan losses.

# Restructuring of Advances

- ▶ A restructured account is one where the bank, for economic or legal reasons relating to the borrower's financial difficulty, grants to the borrower concessions that the bank would not otherwise consider.
- ▶ Restructuring would normally involve modification of terms of the advances/securities, which would generally include, among others, alteration of repayment period/repayable amount/the amount of instalments/rate of interest.

# Restructuring of Advances

- ▶ Standard, Sub-Standard and Doubtful accounts can be restructured
- ▶ Accounts cannot be restructured with retrospective effect
- ▶ Normally, restructuring takes place with the formal consent / application of the debtor. However, the process can be initiated by bank in deserving cases subject to customer agreeing to the terms and conditions

# Restructuring of Advances

- ▶ Viability should be determined
- ▶ Borrowers indulging in frauds and malfeasance are not eligible for restructuring
- ▶ Restructuring of wilful defaulters may be done with Board's approval, where the bank satisfy itself that the borrower is in a position to rectify the wilful default
- ▶ BIFR cases are not eligible for restructuring without their express approval



# Restructured Advances - Asset Classification Norms

- ▶ Accounts classified as standard assets should be immediately re-classified as sub-standard assets on restructuring
- ▶ Restructured accounts should be upgraded only when all the accounts perform satisfactorily during the specified period
- ▶ Specified period means a period of one year from the commencement of the first payment of interest or principal, whichever is later, on the credit facility with longest period of moratorium under the terms of restructuring package

# Restructured Advances - Asset Classification Norms

- ▶ Any additional finance may be treated as standard asset during the specified period
- ▶ If the restructured asset is as sub-standard or a doubtful asset and is subjected to restructuring, on a subsequent occasion, its asset classification will be reckoned from the date when it became NPA on the first occasion.
- ▶ Interest income in respect of restructured accounts classified as standard assets will be recognized on accrual basis and that in respect of the accounts classified as NPA will be recognized on cash basis

# Recent Ammendments

- ▶ RBI Circular Dated 01 / 01 / 2019 related to restructuring of advances – MSME Sector.

[MSME restructuring 01.01.2019.PDF](#)

One Time restructuring of existing Loans to MSME allowed without downgrade in asset classification.

Subject to following terms and conditions :

# Conditions

- ▶ 1) aggregate exposure does not exceed 25 crores (Fund Based + Non fund based)
- ▶ 2) Account is in default but “Standard” as on 01/01/2019
- ▶ 3) Account continues to be standard till date of implementation of restructuring.
- ▶ 4) Borrowing entity is GST registered on date of implementation of restructuring. In case of MSMEs exempt from GST registration , this condition will not apply
- ▶ 5) Restructuring is implemented on or before March 31, 2020

# Conditions for restructuring to be treated as implemented

- ▶ 1) All related documentation, incl execution of necessary agreements between lenders and borrower/ creation of security charge/ perfection of securities are completed by all lenders and
- ▶ 2) New capital structure and/or changes in the terms and conditions of existing loans get duly reflected in books of all lenders and the borrower.

# Conditions contd...

- ▶ In case an NPA account is restructured, extant asset classification norms pertaining to restructuring of NPAs will apply.
- ▶ Additional provision of 5% needs to be made in respect of accounts restructured under these instructions.

# Latest Circulars for NPA

- ▶ Circular No.RBI/2019–20/160 DOR No.BP.BC.34/21.04.048/2019–20 dated February 11, 2020.
- ▶ [msme RESTRUCTURING 11.02.2020.PDF](#)
- ▶ [Prudential Norms on Income Recognition, Asset Classification and Provisioning Pertaining to Advances – Projects under Implementation](#) dated 07.02.2020
- ▶ [07.02.2020 IRAC CIRCULAR ON PROJECTS UNDER IMPLEMENTATION.PDF](#)

# Computation of NPA Levels

Particulars	Amount
Standard Advances	
Gross NPAs	
Gross Advances (Standard Advances + Gross NPA)	
Deductions	
(i) Provisions held in the case of NPA	
(ii) DICGC / ECGC claims received & held pending adjustment	
(iii) Part payment received & kept in suspense account	
(iv) Balance in sundries account in respect of NPA	
(v) Floating provisions	
(vi) Provision in lieu of diminution (restructured NPAs)	
(vii) Provision in lieu of diminution (restructured standard assets)	
Net Advances (Gross Advances - Deductions)	
Net NPAs {Gross NPAs - Deductions (i+ii+iii+iv+v+vi)}	



