THE SIGNIFICANCE OF FORENSIC AUDIT IN MITIGATING FRAUDS: IN REFERENCE TO INDIAN BANKING SCENARIO

ANANYA BASU ROY CHOWDHURY.

RESEARCH SCHOLAR,

UNIVERSITY OF CALCUTTA.

ABSTRACT

Forensic audit is defined as an investigation of evidence pertaining to a case to ascertain if it complies with predetermined standards, conducted in a way that is appropriate for the court. In his study, Cressy (2012) clarified that particular steps are taken in forensic auditing to generate evidence. Recent years have seen a number of banking collapses and scandals in India, jeopardizing the economy and shattering investor faith. There are several instances of banks failing as a result of money being siphoned off and diverted into dubious ventures that ultimately harm consumers and the banking sector. This paper aims in finding the significance of forensic audit in the banking sector by understanding the data from RBI annual reports.

Keywords: Forensic Audit, Banking Sector, Economy, RBI Annual reports.

INTRODUCTION

A type of financial audit called forensic auditing looks at a company's past financial records to look for any indication of illegal activities, like accounting fraud or money theft. Investigative approaches are prompted by suspicions and uncertainties, which either confirm or dispute the doubts of a forensic audit. In contrast to financial audits, forensic audits are meant to examine an organization's financial records in order to gather proof of fraud that can be used in court. Now this forensic audit is becoming a necessity. Now when we are talking about frauds, banking sector frauds are increasing day by day. Frauds like Punjab National Bank Scam: In 2018, diamond sellers Nirav Modi and Mehul Choksi scammed the Punjab National Bank (PNB) of more than Rs. 13,000 crores. For Modi and Choksi's businesses to be able to secure loans from other banks, PNB personnel issued false letters of undertaking (LoUs) to them. Next example is the Reserve Bank of India (RBI) issued a moratorium on Yes Bank in March 2020 as a result of the bank's poor financial situation. It was later discovered that Rana Kapoor, the bank's founder, had engaged in fraudulent actions, including financing to businesses with questionable financial standing and syphoning off funds. Another example is the loan default involving Kingfisher Airlines, which cost a group of banks more than Rs. 9,000 crores. Vijay Mallya, the airline's owner, was accused of money laundering and fraud in 2016, and he left the country. So we see that as banking industry is increasing so is the fraud. Banking sector cannot give full security to its customer. It lacks in appropriate training of its employee as well as it has poor internal controls

so in this case employing forensic audit is very much needed as with the help of this bank can understand the loopholes and can prevent in fraud which in turn less NPA can be seen.

LITERATURE REVIEW

In their research article, Saxena et al., 2021 observed that financial fraud is growing in the Indian government's banking sector. Forensic auditing is therefore necessary to find financial frauds, which have grown to be a serious threat to India's growth strategy. The statutory audit mechanism in place today does not conduct in-depth audits. A significant number of fraud cases have been reported worldwide, which has caught the attention of firm stakeholders and is having a detrimental influence on investor returns. The result is substantial damage to the organization's existence and its value in the marketplace.

In their paper "An Overview of Forensic Accounting in India," George. P. and Podoli. L addressed their opinions on proposing some strategies for implementing forensic accounting in India. The study also concentrated on the applications of forensic accounting, fraud detection methods, how government organisations fight fraud, and the skills and expertise needed by a forensic accountant. The three dimensions of fraud examination—fraud detection, fraud investigation, and fraud prevention—were examined by the writers. Additionally, they concentrated on the government agencies that fight frauds as well as the abilities and credentials needed for a forensic accountant.

A study "Training in Forensic Audit in the Banking Sector: A Status Report of Banks in Chandigarh," by Monica Aggarwal and Gurpartap Singh was on the steps Chandigarh banks have taking to prepare for dealing with various frauds and the kinds of systems they are employing to protect themselves from such frauds. The banks' technical readiness to manage risk and meet requirements for compliance was emphasised, and more emphasis was placed on the forensic audit training that the banks in Chandigarh have given to the identified staff. The writers believed that for banks to work more diligently, there was a need for the staff to receive appropriate training that would close any potential gaps in internal processes.

"Forensic accounting" is defined by Manning (2002) as "the combination of accounting, auditing, and investigation abilities in accordance with a degree that is required by a court of competence to handle matters in dispute in the framework of civil and criminal litigation. Investigation, dispute settlement, and litigation support are the three main facets of forensic accounting.

In their work "A Study on Causes and Prevention of Fraud in the Banking Industry," Vigneshwaran T.S. and Yokesh M made an effort to address issues like banking frauds as the number of NPA cases has increased over the past several years in scheduled commercial banks, particularly public sector banks. According to them, frauds occur as a result of inadequate top-level management oversight, employee conspiracies, flawed incentive systems, weak regulatory frameworks, a lack of necessary tools and technology that can identify early warning signs of fraud, etc. The slow reporting mechanism and several flaws are the main causes of scams and NPAs. The authors advised banks to stop and lessen the likelihood of fraud in the Indian banking industry in the future.

In the study "A study on forensic accounting and Risk Management in selected banks of Mumbai "By Kanojia and Sangita Laxman we can see that author said after all the findings that is forensic accounting is very important and it has become an integral part of the banking. All the employees must be aware of the techniques so that early detection of fraud can be done.

In the study "A study of Forensic Auditing Techniques in early detection of non-performing asset in Public and Private Sector Banks in India "by Mehta, Kamakshi where the author stated that by using various forensic auditing techniques frauds can be reduced and fraudulent manipulations of financial statement can also be reduced.

Research on the use of forensic audit as an investigative tool to combat banking crimes was undertaken by Ghosh P. in 2021. The goals of the researcher are to comprehend and analyse the pattern of frauds hurting the banking industry in India as well as to examine the applicability of forensic audit. In light of the RBI

findings, researchers have examined the quantity of fraud cases and fraud offences in the Indian banking industry.

A new horizon in the accounting industry has been explored by Ray K (2021). The researcher's goals were to introduce forensic accounting, describe internal and external auditor limitations, describe the nature and characteristics of forensic accounting, describe its history, define frauds, highlight the importance of forensic accountants, and discuss the government's role in reducing fraud and corruption in India. In order to reduce frauds and scams, researchers found that the services of forensic accountants, government fund investors, CBI, SEBI, RBI, etc. were helpful.

A study on the meaning, tool, and survey of the fraud risk assessment was conducted by Gollapudi A. in 2021.Researchers concluded that fraud recovery is challenging, and organizations typically receive nothing. However, a comprehensive fraud risk management strategy can assist in shielding the company from the financial, human, stakeholder, and reputational effects of fraud.

OBJECTIVES OF THE STUDY

- To understand the meaning and scope of forensic auditing.
- To understand the importance of conducting forensic audit by studying the amount of fraud cases in Indian Banking Sector that resulted in the past five years.
- To study about various tools and technique that can be used to reduce fraud.

RESEARCH METHODOLOGY

The research is based on Secondary data and is theoretical in nature. The study is based on the data collected from RBI Annual report for the last five financial years. Data has also been collected from from various journals, papers.

DATA ANALYSIS AND INTERPRETATION

Table 1: Number of Bank fraud cases across India during the last five financial years from 2019-2023:

F.Y 2019	6,800
F.Y 2020	8,703
F.Y 2021	7,359
F.Y 2022	9,103
F.Y 2023	13,530

Table 2: Fraud Cases in Various Banking Operations   (Amount in Rs. Crore)

Area of Operations	2018-2019		2019-2020		2020-2021		2021-2022		2022-2023	
	Number of Fraud	Amount	Number of Fraud	Amount	Number of Fraud	Amount	Number of Fraud	Amount	Number of Fraud	Amount
Advances	3,603 (53.0)	64,539 (90.2)	4,608 (52.9)	1,81,942 (98.1)	3,501 (47.5)	1,37,023 (99.0)	3,833 (42.2)	57,733 (96.5)	4,109 (30.4)	28,792 (95.2)
Off Balance Sheets	33 (0.5)	5,538 (7.7)	34 (0.4)	2,445 (1.3)	23 (0.3)	535 (0.4)	21 (0.2)	1077 (1.7)	14 (0.1)	296 (1.0)
Forex Transactions	13 (o.2)	695 (1.0)	8 (0.1)	54 (0.0)	4 (0.1)	129 (0.1)	7 (0.1)	7 (0.0)	13 (0.1)	12 (0.0)
Card/ Internet	1,866 (27.5)	71 (0.1)	2,667 (30.8)	129 (0.1)	2,545 (34.6)	119 (0.1)	3,596 (39.5)	155 (0.3)	6,659 (49.2)	156 (0.9)
Deposits	593 (8.7)	148 (0.2)	530 (6.1)	616 (0.3)	504 (6.8)	434 (0.3)	471 (5.2)	493 (0.8)	652 (4.8)	258 (0.9)

Inter Branch Accounts	3 (0.0)	0 (0.0)	2 (0.0)	0 (0.0)	2 (0.0)	0 (0.0)	3 (0.0)	2 (0.0)	3 (0.0)	0 (0.0)
Cash	274 (4.0)	56 (0.1)	371 (4.3)	63 (0.1)	329 (4.5)	39 (0.0)	649 (7.1)	93 (0.2)	1470 (10.9)	158 (0.5)
Cheques/DDs, etc	189 (2.8)	34 (0.1)	201 (2.3)	39 (0.0)	163 (2.2)	85 (0.1)	201 (2.2)	158 (0.3)	118 (0.9)	25 (0.1)
Clearing Accounts	24 (0.4)	209 (0.3)	22 (0.2)	7 (0.0)	14 (0.2)	4 (0.0)	16 (0.2)	1 (0.0)	18 (0.1)	3 (0.0)
Others	200 (2.9)	244 (0.3)	250 (2.9)	173 (0.1)	278 (3.8)	54 (0.0)	300 (3.3)	100 (0.2)	474 (3.5)	434 (1.4)
Total (In, %)	6798 (100.00)	71,534 (100.00)	8,703 (100.00)	1,85,468 (100.00)	7,363 (100.00)	1,38,422 (100.00)	9,097 (100.00)	59,819 (100.00)	13,530 (100.00)	30,252 (100.00)

Source: RBI Annual Report 2020-2021, 2021-2022, 2022-2023

Table 3: Fraud Cases in Bank Group Wise   *(Amount in Rs. Crore)*

Bank Group/Institution	2018-2019		2019-20		2020-21		2021-22		2022-23	
	Number of Frauds	Amount Involved	Number of Frauds	Amount Involved	Number of Frauds	Amount Involved	Number of Frauds	Amount Involved	Number of Frauds	Amount Involved
Public Sector Banks	3,704 (54.5)	64,207 (89.8)	4,410 (50.7)	1,48,224 (79.9)	2,888 (39.4)	77,879 (58.8)	3,075 (33.8)	40,015 (66.9)	3,405 (25.2)	21,125 (69.8)
Private Sector Banks	2,149 (31.6)	5,809 (8.1)	3,065 (35.2)	34,211 (18.4)	3,705 (50.5)	45,515 (34.4)	5,332 (58.6)	17,387 (29.1)	8,932 (66.0)	8,727 (28.9)
Foreign Banks	762 (11.2)	955 (1.3)	1,026 (11.8)	972 (0.5)	519 (7.1)	3110 (2.4)	494 (5.5)	1,206 (2.0)	804 (5.9)	292 (1.0)
Financial Institutions	28 (0.4)	553 (0.8)	15 (0.2)	2,048 (1.1)	22 (0.3)	5853 (4.4)	9 (0.1)	1,178 (2.0)	9 (0.1)	70 (0.2)
Small Finance Banks	115 (1.7)	8 (0.0)	147 (1.7)	11 (0.0)	114 (1.5)	30 (0.0)	155 (1.7)	30 (0.0)	312 (2.3)	31 (0.1)
Payments Banks	39 (0.6)	2 (0.0)	38 (0.4)	2 (0.0)	88 (1.2)	2 (0.0)	30 (0.3)	1 (0.0)	68 (0.5)	7 (0.0)
Local Area Banks	1 (0.0)	0.02 (0.0)	2 (0.0)	0.43 (0.0)	2 (0.0)	(0.0)	2 (0.0)	2 (0.0)	0 (0.0)	0 (0.0)
Total	6,798 (100.00)	71,534 (100.00)	7,363 (100.0)	1,38,422 (100.0)	7,338 (100.0)	1,32,389 (100.0)	9,097 (100.0)	59,819 (100.0)	13,530 (100.0)	30,252 (100.0)

Source: RBI Annual Report 2020-2021, 2021-2022, 2022-2023.

From table 1, table 2, table 3 we can see that fraud cases registered during the last five years have increased and thus the need of forensic auditing is required very much. From table 2 we can see among the areas of

operations in banks where the maximum fraud is happening and that area should be taken care of and from table 3 we an see though in every type of bank the fraud cases are increasing but it is maximum in case of private banks.

Now with the help of the tools which are used in forensic audit like CAAT which is Computerised assisted auditing techniques is a process for obtaining and checking out electronic records. It uses computer software to examine vast amounts of electronic data for deviations. CAAT is used to streamline or simplify the data analysis and audit process. The branch has a committed group of Computer audit experts (CAS) that create and manage CAAT and respond to requests for help from auditors, then data mining technique where Analysing deviations and links might help one uncover or understand uncommon items. Link search analysis aids in identifying odd patterns. This method uses an object and a "pattern recognition" algorithm to "extract" any unusual or questionable cases. Divergence and link analysis are sometimes referred to as Bayesian potential casual networks and critical graphical approaches, can help in reducing fraud which results in NPA in banks.

There are various models like which is used as a forensic audit technique such as Altman z score which is a model for predicting a company's likelihood of insolvency. Profitability, leverage, liquidity, solvency, and activity ratios are all considered in the calculation. A corporation may be on the verge of bankruptcy if its Altman Z-score is close to zero, while a score closer to three indicates sound financial standing. Then there is Beneish's M-Score which is a statistical model that determines whether a corporation has manipulated its profitability by using eight financial ratios that are weighted by coefficients. It was developed by Professor Beinish. Beinish hypothesises that businesses are motivated to falsify earnings if they are experiencing rapid sales growth, declining gross margins, growing operating costs, and increasing leverage. By expediting revenue recognition, enhancing cost deferrals, raising accruals, and decreasing depreciation, they are likely to manipulate earnings.

CONCLUSION:

As we know in the scientific process known as forensic audit, financial data is first acquired, then examined, and then presented in a suitable document that can stand the test of time in courtrooms. The forensic study will assist the banks in determining the extent of fraud in each industry, their causes, and potential corrective actions for actual income recognition, asset categorization, and provisioning. To determine the root causes and consequences of frauds, the role played by different sectors in raising frauds levels, etc., the origins and impacts of frauds must be microscopically investigated. And also, on the other hand the Non-Performing Assets (NPA), which also results due to various frauds and bankers' ineffectiveness in evaluating credit and credit monitoring an be lessened through forensic audit, which also aids in keeping the amount of NPAs in banking under control A strong banking industry is necessary for an expanding economy and NPA growth affects the company's overall profit margin and the value to its shareholders because of the increased need for provisions.

REFERENCES:

- Ghosh P. (2021), "application of forensic audit: an investigative tool to combat with banking frauds" Journal of the management Accountant published by the institute of cost accounts of India. ISSN 0972- 3528, Vol.56, Issue 10, October 2021, pp 66-68.
- Ray K (2021), "forensic accountant: a new frontier in the accounting profession" the management accountant journal of the institute of cost accountants of India, Vol. 56, No.10, October 2021, ISSN 0972- 3528, pp 21-26.
- Gollapudi A. (2021), "Fraud Risk Assessment- Meaning, Tool & Survey" Journal of the management Accountant published by the institute of cost accounts of India. ISSN 0972-3528, Vol.56, Issue 10, October 2021, pp 18-20.

- Sangeeta L. (2022) , " A study of Forensic Accounting and Risk Management in selected banks of Mumbai".
- Reserve Bank of India Report 2020-2021. Pp 151-152.
- Reserve Bank of India Report 2021-2022.pp 141-142.
- Reserve Bank of India Report 2022-2023. Pp 141-142.
- Sharma, A. (2016). BANKS' NPA CONTROL THROUGH FORENSIC AUDIT, International Journal of Advanced Research in ISSN: 2278-6236 Management and Social Sciences,5(8).
- Aggarwal, M., & Singh, G. (2015). Training in Forensic Audit in the Banking Sector: A Status Report of Banks in Chandigarh, Gian Jyoti E-Journal, 5(2).
- Agrawal, S. (2020). Why rising forensic audits need clear set of rules; ghosts of Sahara, Satyam scams still haunt, The Financial Express.
- Akenbor, C.O. and Ironkwe, U., (2014). Forensic auditing techniques and fraudulent practices of public institutions in Nigeria. Journal of Modern Accounting and Auditing,10(4).
- Anitha, S., Salomi, S., & Manjula. (2015). Impact of Forensic Accounting and Audit in Detecting Fraud, "Accounting, Finance and Management: Current Issues and Developments.
- Anthala, H. R. (2014). Research paper on Case laws of Fraud, forgery and Corruption in Banks and Financial Institutions in India. IOSR Journal of Economics and Finance (IOSRJEF), Volume 3 (6), PP 53-57.
- AO Enofe, Utomwen, OA., & Danjuma E.J., (2015). The Role of Forensic Accounting in Mitigating Financial Crimes, International Journal of Commerce and Management,1(1).
- Ashu, B. A. (2009). A study to investigate the reasons for bank frauds and the implementation of preventive security controls in Indian banking industry. Int. Journal of Business Science and Applied Management ,4 (3), 1- 21.
- Baxi, k. (2022). A study on Banking Sector frauds with special references to Forensic Accounting [Doctoral thesis, GLS University].
- Behel, V. (2021). Perspective of Forensic Accounting in India. International Journal of Research and Analysis in Commerce and Management, 1(1), 8-8.