

REDUCING NPAS IN INDIAN BANKS

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Abstract: In recent past, many Corporate frauds & failures of Financial Institutions and private banks in India like Satyam Computers, Enron, WorldCom, Madoff and in India like IL & FS and Deewan housing failure, Yes bank failures have rocked the world and also Indian markets due to fraudulent financial reporting. This has justified failure of statutory audit, internal control and corporate governance in those companies. Forensic Accountants through their audit help in reducing fraudulent reporting.

Forensic audit is a process of auditing of accounts in such a manner that can be produced in court of law. A **forensic auditor** finds out weakness in control system of management of the organisation and also identifies persons involved in exploiting these situations inside the company. This helps in controlling frauds in companies.

The increase in NPA of banks has become a menace in the present period and most of the banks are facing this problem. Increase in NPAs leads to more requirement of capital for provisioning and less fund available for giving loans to public. That generates shrinking of profit for banks.

The Banks' loans become bad due to improper analysis of credit requirement of any project and lack of proper monitoring by bankers after disbursement of loan to the company. They never verify end use of funds sanctioned to the firm.. This results in borrower taking advantage of laxity on the part of banks. The borrower misuses funds by diverting these funds for personal benefits.. The forensic accountant checks actual financial transaction through firm's bank's account statement. Hence they prevent generation of nonperforming assets in banks

This study concentrates on analysis of NPA accounts in Indian Banks from **forensic audit angle** as non performing assets in Indian Banks have touched more than Rs. ten lacs crore.

keywords: nonperforming assets, forensic audits, banks, cash flows, financial statements

I. INTRODUCTION

After the economic liberalisation of 1990s, there was unprecedented growth in banking industry. This led to massive expansion of banks in every nook and corner of the country. Banks started giving loans to private corporate sector in a big way without adhering to the banking norms for credit disbursement. There was a lack of proper credit assessment and credit management on the part of bank management. Besides, deregulation of interest rates, reduction of Statutory Liquidity ratio (SLR), and Cash Reserve Ratio (CRR), priority sector lending norms were expanded to dilute the earlier provisions. This was done to increase share of private corporate sector in Bank's credit portfolio at the cost of small scale industry and agriculture sector. But, these banks were not confident in giving loans to private sector companies. As such, there was no significant improvement in lending to private entities prior to commencement of economic boom of 2003-04. (Chandrasekhar and Pal 2006).

This led to creation of bad loans in Banking Industry since 2003-04. Narasimham Committee Report-I of 1991, (on Non-Performing Assets in the banking sector) has started several reforms in banking sector. But, "after global financial crisis of 2008, exports declined and the external sector stopped providing any incentive for economic growth. Companies had their stocks unsold. As a result, they gradually reduced their production capacity. Their turnover declined and profits reduced drastically. They defaulted in making loan payments to banks. This led to creation of bad loans or NPAs in banks which became unmanageable. This affected profitability of banks which in turn reduced their lending to corporate sector due to strict provisions for their bad loans. The present prevailing situation during covid19 and post covid19 is also the same. Although several steps have been taken by RBI to increase liquidity and helping MSMEs with restructuring loans and providing guaranteed emergency credit but still the future is grim. Hence the correct Financial reporting of the financial health of the banks is of utmost importance.

The present Credit growth from PSBs at increased interest rates and sudden fall in private investment after /post Covid. May led to debt distress in India. Which would result in generating large number of non performing assets in Indian Banks.

NON-PERFORMING ASSETS

The section 2(o) of the **SARFAESI Act 2002** defines NPA as: "Non-Performing asset means an asset or account of borrower which has been classified by a bank or financial institution as substandard, doubtful or loss asset in accordance with the directions or guidelines relating to asset classification issued by the Reserve Bank." RBI has said that "if in an exposure, the payment of interest/repayment of instalment of principal or both remain unpaid for a period of 90 days (reduced from 180 days w.e.f. 1st April 2003), such an exposure is to be treated as being non-performing."

The basic criteria for an NPA are default –either on interest or principal instalment that is due as per the terms of the contract.

NPA is a standard criterion for assessing commercial bank credit risk globally.

NPA CRISIS

“Banks are responsible for increasing their NPA woes by propping up ailing companies with fresh loans even as firms struggled to repay old debts .

The growth of NPA in case of most of the PSBs especially IDBI IL & FS, Deewan Housing, Yes Bank tells the sorry state of handling credit portfolio in most of the banks of the country. In fact, the same is true for other PSBs as loan accounts are handled in casual way similar to what has happened at IDBI, IL & FS, Deewan Housing, Yes Bank. “IDBI, IL & FS, Deewan Housing, Yes Bank failures are symptoms of a disease that doctor chose to ignore”. “Everyone including RBI and the finance ministry saw it coming but they not take necessary action at the right time.” “IDBI’s/IL & FS, Deewan Housing, Yes Bank distress is reflective of India’s banking system as a whole.”

Asset quality review in Banks, initiated by RBI during the Governorship of Dr. Raghurajan, has increased NPA in PSBs from 6% in March 2015 to 9.6% in March 2017 while in private sector upto 4.6%. **(Shubhabrata Basu, Moovendhar V.2017)**. By March 2019, total NPAs of Indian Banks have touched ten lacs crore.

The AQR exposed the deep rooted and systemic malaise prevalent in PSBs. The aggressive lending and loan frauding as mentioned by **Dr. Rajan** are prevalent in every banks. Besides, NPA recognition and its reporting had been subjective, contingent on managerial discretion. **Shubhabrata Basu et al (2017)**. The purpose of AQR was to give an opportunity to the banks to recognise NPA and come out clean.

The steps taken by RBI and Government regarding cleaning of balance sheets of the banks and keeping bank under no lending regime if RBI criteria are violated and subsequent merger of the Banks are steps to show that big banks are profitable but the actual issue of addressing the cause of NPA is let down. Even though the banks may comply with all Basel norms but issue of ever increasing NPAs of PSBs is not addressed

The recent creation of Asset Management Companies to address the NPA issues is yet to take up in fullest, which would take up certain gestation period before delivering any results.

The then RBI Governor Dr. Raghuram Rajan while deposing before Public Accounts Committee (PAC) of Parliament gave six reasons for this increase in NPAs

- global and domestic macroeconomic instability
- delays in statutory approval for running projects
- aggressive lending leading to high corporate leverage
- wilful defaults
- loan frauds(including window dressing and ever greening of loans)
- corruption

With the end of boom period in 2011-12, NPAs of Banks started increasing. Banks started restructuring corporate debts to hide actual amount of NPAs. The total stressed loans in Indian Banks compared to total Bank loans increased from 4% in 2010-11 to 11% in 2014-15. Total Banking loans were Rs.75 trillion (2014-15) and stressed loans were Rs.8.4trillion in March 2015. Public Sector Banks accounted for 90% of stressed loans while their share of total loans were 74%. SBI group accounted for 10.5% of stressed loans while other nationalised banks have 14.8% share of stressed loans.

“There was indiscriminate lending from Rs.18lacs crore in 2008 to Rs.52 lacs crore in 2014 by Indian banks, thereby an increase of Rs.34lacs crore with the consent of RBI as RBI did nothing to control this as admitted by Dr. D. Subbarao , the then RBI Governor. This has made NPA problem more serious.”(Arun Jaitley, former Finance Minister said in Parliament)

Reasons for creating non performing assets in Indian Banks

• “Deficiencies in evaluation can be somewhat compensated for by careful post lending monitoring, including careful documentation and perfection of collaterals as well as ensuring assets backing the promoter guarantees are registered and tracked.”(**Raghuram Rajan, ET dt.21.6.17**)

• “Unfortunately, too many projects were left weakly monitored even as costs increased.”

□ **“Beyond loan appraisals, banks have to build teams that would do forensic audit of promoters’ equity claims, and monitor the way funds are used and misused.” (ET dt.21.6.17).**

• Gross NPA (GNPA) increasing to 9.5% as on 31.3.2017 from 3.6% as on 31.3.2014. This deterioration was higher in PSB due to large loans given to power, highways, steel, textiles etc .in relation to private sector banks

• GNPA of PSB became 11.4% as on 31.3.2017 from 4.4% as on 31.3.2014. Private sector (GNPA) increased to 4.2 % from 1.8%.

With the increase of NPAs in banks, they have to make more provision in their books and this resulted in less profits for them..

In all cases Banks have been asked to get **FORENSIC Audit of every NPA accounts having limits of Rs.50crore by Regulator RBI.**

Hence, Forensic Audit has taken important role in helping banks in reducing NPAs in banks gradually..Actually, the Banks' loans become bad due to improper analysis of credit requirement of any project and lack of proper monitoring by bankers after disbursement of loan to the company. They never verify end use of funds sanctioned to the firm.. This results in borrower taking advantage of laxity on the part of banks. The borrower misuses funds by diverting these funds for personal benefits. The forensic accountant checks actual financial transaction through firm's bank's account statement. Hence they prevent generation of non performing assets in banks. This also helps in finding out whether there is collusion among bankers and promoters of the companies for their illegal gains

FORENSIC AUDIT OR ACCOUNTING

According to AICPA (American Institute of Chartered Public Accountant), "Forensic Accounting is the application of accounting principles, theories, and disciplines to facts or hypotheses at issues in a legal dispute and encompasses every branch of accounting knowledge."

"The enactment of the Benami Property Act increases the importance of Forensic audit in the country's fight against financial offenders." (Economic Times dt.20.2.2017).

II.LITERATURE REVIEW:

Crumbley(2003) says " **Forensic science** is defined as application of the laws of nature to the laws of man." The science mentioned here is accounting science where economic data is examined and interpreted to get true picture.

Joshi(2003) says, " Forensic Accounting is the application of specialized knowledge and specific skill to stumble up on the evidence of economic transactions."

Zysman(2001) says, " Forensic accounting as the integration of accounting, auditing, and investigating skills". "Forensic accounting is identified as that branch of accounting which can be produced suitably in court of law for proving any financial case."**Crumbley 2006).**

Coenen (2005) claims, " forensic accounting involves the application of accounting concepts and techniques to legal problem."

According to Canadian Institute of Chartered Accountant (2006),

" „Investigative and forensic accounting engagements" are those that:

--require the application of professional accounting skills, investigative skills and an investigative mindset, and

--involve disputes or anticipated disputes or where there are risks, concerns or allegations of fraud or other illegal or unethical conduct".

Koh et al(2009) says, " Forensic Audit as a science dealing with the application of accounting facts gathered through auditing methods and procedures to resolve legal problems. It is a combination of investigative, accounting and auditing skills."

Bologna and Lindquist (1987) had defined forensic accounting as "the application of financial skills and an investigative mentality of unresolved issues conducted within the framework of rules of evidence." **Bhasin(2007)** says " Forensic accounting is an emerging discipline. It encompasses financial expertise, fraud knowledge and a sound knowledge and understanding of business reality and the working of the legal system."

" It is associated with the detection of white collar crime such as Frauds and Embezzlements, Insurance casualty claims, Loss measurement, detection of Accounting malpractices, and General abuse of trust relationships, helping in verification of hidden assets during divorce proceedings."**(Okaye et al (2009) andBhasin (2007).**

"Forensic accounting covers two broad areas of practice. These are litigation Support and investigative accounting."**(Bhide 2012).** " It is different from the old debit or credit accounting as it provides an accounting analysis that is suitable to the organization which will help in resolving the disputes that arise in the Organization."**(Owojori,A.A.; T.O. Asaolu 2009).**

"Forensic Accountants utilize accounting, auditing and investigation skills while conducting an investigation. They should collect, analyse and interpret large volume of data and documentation ranging from the more usual accounting records and management information systems to memos, correspondence and other less obviously financial data."

Owojori (2009). They should have knowledge of psychology, having sixth sense, can read between lines, critical thinking, unstructured problem solving, analytical proficiency, thorough legal knowledge, investigative mind to analyse complex problems.**(Bhasin 2007).** An Audit fraud in today's world has given a new dimension to Corporate Fraud with drastic consequences. **(Niall F. Coburn,2006).**

According to Manning (2002), "forensic accounting is the combination of accounting, auditing and investigative skills to a standard that is required by a court of jurisdiction to address issues in dispute in the context of civil and criminal litigation. Forensic accounting essentially encompasses three major areas investigation, dispute resolution and litigation support."**(www.buzzle.com/articles).**

In investigation, the forensic accountant determines whether or not certain criminal matters, including financial crimes, such as securities frauds, employee theft, insurance fraud, management theft, payroll fraud, corporate fraud among others have occurred. The forensic accountant in such cases investigates and comes to a conclusion so that such frauds/crimes do not occur in future and presents its report in court of law if so required. He appears in court of law as an expert witness. According to **Sadiq(2008)**, “ Forensic audit involves the examination and interpretation of economic information. He actually investigates, appraises and documents financial fraud and white collar crimes (such as embezzlement and frauds) by staffs, managers and other frauds or crimes in the organization. He calculates and evaluates losses, damages and asset misappropriation and prepares a report which is used as legal document in a court of law. He also calculates the economic loss resulting from a breach of contract. That is used against fraudsters/ economic offenders for giving them punishments.” .

Zysman(2004) defined Forensic Accounting in his paper, ”Forensic Accounting Demystified” as combination of accounting, auditing and investigative skills.

Need of Forensic Analysis of NPAs of Banks

. Forensic Analysis of NPA in bank provides the answer about the level of NPAs under various categories, NPAs in various sectors, real causes of NPA etc. This study helps in analysis of NPA accounts through forensic angle.

Objectives

The objective of this research is focused on analyzing nonperforming assets of Indian Banks and the role of forensic audit in controlling NPAs of these banks .

III. RESEARCH METHODOLOGY

An exploratory study, it primarily highlights the causes of NPAs in banks during appraisal, sanction and disbursal and post disbursal stage and the role of Forensic audit in controlling NPAs. Data was collected through survey sampling and information was obtained through Questionnaire. The Questionnaire was administered to bank officials/desk officials/loan officials etc. of four Indian Banks(SBI, ICICI Bank, PNB, Axis Bank) . Two hundred questionnaires were sent to bank officials and one hundred sixty questionnaires were filled and returned for empirical analysis. The questionnaire asked the participants about role of bankers and the reasons for loans turning NPAs in different Banks . They were also asked about the role/importance of Forensic audit in reducing/controlling NPAs in Banks. The data was analyzed and percentages were computed to quantify the weight of the variables. Z score test of mean was computed for the first three hypotheses and Z score test of proportion was computed for the fourth hypothesis.

Statement of Hypotheses:

H1— There is no significant relationship between forensic audit and loans of Indian banks.

H2- There is no significant relationship between forensic audit and NPAs of Private sector banks.

H3— There is no significant relationship between forensic audit and NPAs of Public sector banks.

H4— There is no significant relationship between forensic audit and NPAs of Indian banks

Population mean is considered as the average of equal responses to the options while considering hypothesis as the relevant data were gathered on a Likert Scale of 1-5.

For the hypothesis, the expected proportion is taken as the share obtained from expected equal distribution to the options to each variables in the test. Every variable has three options and for last hypothesis, the expected proportion is 50%. Besides, empirical studies were also done using questionnaire.

Testing Of Hypothesis:

Hypothesis one null says that there is no statistically difference between the mean of our sample and that of the population. The sample mean was 3.91, standard deviation was 1.06 and the Z-score statistic was 5.632. Since this is more than table value of 1.96 coupled with the 78% agreement response, we agree that the difference is statistically important and forensic accountants are required in Indian Banks.

In case of Hypothesis two, the mean of the response was 3.67, standard deviation was 0.921 and the Z-score equal to 1.67. The Z calculated was less than the table values. The null hypothesis holds. The forensic accountants are relevant in controlling NPAs in private sector Banks.

While calculating Hypothesis three, we compare the sample mean to population mean of respondent opinion on the statement that services of Forensic accountants are required in public sector banks. Here, Mean was 3.98, standard deviation 1.101 and Z-score is equal to 2.15 and greater than 1.96, the table value for Z. Hence, we reject our null hypothesis three that the services of the forensic accountants are required more in the public sector, and come to conclusion that the requirement of forensic accountants are more in public sector banks is correct and statistically significant.

While testing Hypothesis four, the Z- score result obtained was higher than the table value. This says about rejection of this null hypothesis. this confirms that the respondents opined that the services of Forensic accountants are required for reducing NPAs in Indian Banks.

IV .CONCLUSION/FINDINGS

This paper observed that there is large number of NPAs in Indian Banks . These are more in public sector banks compared to private sector banks. This has adverse impact on Indian economy. We found empirically that importance of Forensic accountants are increasing and their role in reducing NPAs is significant in Indian Banks. They proved to be more effective in controlling NPAs in Public Sector Banks compared to private sector Banks.

V. LIMITATION

The following limitations have been observed while doing research:

- Bank officers are very sensitive in disclosing their NPAs figures as that expose weakness of internal control system prevalent in those banks and hence are reluctant in divulging their actual figures. That affect quality of data sometime.
- The research has utilized feedback from officers working in various banks across the country. Sometimes, their opinion is subjective and that affect the quality of data.
- The sample size is also small and participants from many banks have not been considered such as other scheduled commercial banks, cooperative banks.

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