AUDIT OF FOREIGN EXCHANGE TRANSACTIONS

1.00 INTRODUCTION:

The Foreign Exchange Management Act (FEMA) was an act passed by Parliament in 1999 which replaced Foreign Exchange Regulation Act.

The most important legislation in this respect, was introduced in our country for the purpose of facilitating external trade and payment and for promoting the orderly development and management of foreign exchange market in India.
2.00 ACTIVITIES UNDER FOREIGN EXCHANGE (FX) TRANSACTIONS

- Each FX transaction has to be audited considering: RBI/ FEMA/ FEDAI / ECGC / Bank’s Internal Guidelines.

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**Exports**:  
- Pre-shipment  
- Post Shipment  
- Advising LCs  
- Bills for collection

**Imports**:  
- Opening LCs  
- Bills for collection  
- Buyer’s Credit  
- Guarantee

**Remittances**:  
- Sale & Encashment of FC notes  
- Inward & Outward Remittances  
- Non Resident Deposits

**FX Dealings**:  
- Forward Contracts  
- Cash handling like Nostro etc.
3.00 **EXPORT TRADE:**

- Export trade is regulated by the Directorate General of Foreign Trade (DGFT) and its regional offices, functioning under the Ministry of Commerce and Industry, Department of Commerce, Government of India.
- Policies and procedures required to be followed for exports from India are announced by the DGFT, from time to time.
- Export of Goods and Services from India is allowed in terms of clause (a) of sub-section (1) and sub-section (3) of Section 7 of the Foreign Exchange Management Act 1999 (42 of 1999), read with Notification No. G.S.R. 381(E) dated May 3, 2000 viz. Foreign Exchange Management (Current Account) Rules, 2000, as amended from time to time.
- Export Credits can be categorized as follows:
  - Pre-Shipment Finance
  - Post-Shipment Finance

3.01 **PRE-SHIPMENT FINANCE**

A financial institution gives Pre Shipment Finance when the seller wants the payment of the goods before shipment. The main objectives behind pre-shipment finance or pre export finance is to enable exporter to:

- Procure raw materials.
- Carry out manufacturing process.
- Provide a secured warehouse for goods and raw materials.
- Process and pack the goods.
- Ship the goods to the buyers.
- Meet other financial cost of the business.
Type of Pre-Shipment Finance

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Types</th>
<th>Particulars</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Packing Credit</td>
<td>Facility is provided to an exporter who satisfies the criteria such as</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- A ten digit importer exporter code number allotted by DGFT.</td>
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<tr>
<td></td>
<td></td>
<td>- Exporter should not be in the caution list of RBI.</td>
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<tr>
<td></td>
<td></td>
<td>- If the goods to be exported are not under OGL (Open General License), the exporter should have the required license/quota permit to export the goods.</td>
</tr>
<tr>
<td>2.</td>
<td>Advance against Cheque/Drafts received as advance payment</td>
<td>Exporter receives direct payments from abroad by means of cheques/drafts etc. the bank may grant export credit at concessional rate to the exporters of good track record, till the time of realization of the proceeds of the cheques or draft etc.</td>
</tr>
</tbody>
</table>

Pre-shipment finance is extended in the forms of Packing Credit in Indian Rupees and in Foreign Currency.
3.02 POST SHIPMENT FINANCE

Post Shipment Finance is a kind of loan provided by a financial institution to an exporter or seller against a shipment that has been already made.

Type of Post Shipment Finance

<table>
<thead>
<tr>
<th>Sr. No</th>
<th>Types</th>
<th>Particulars</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Export Bills Purchased/discounted</td>
<td>Export bills issued in terms of sale contract/order may be discounted or purchased by the banks and the same is used in indisputable international trade transactions and the proper limit has to be sanctioned to the exporter for the purchase of export bill.</td>
</tr>
<tr>
<td>2.</td>
<td>Export bills Negotiated (Bills under L/C)</td>
<td>The risk of payment is less under the LC, as the issuing bank makes sure the payment.</td>
</tr>
<tr>
<td>3.</td>
<td>Advance against Export Bills sent for collection basis</td>
<td>Bills can only be sent on collection basis, if the bills drawn under LC have some discrepancies.</td>
</tr>
<tr>
<td>4.</td>
<td>Advance Against Export on consignment basis</td>
<td>Bank may choose to finance, when the goods are exported on consignment basis at the risk of the exporter, for same and eventual payment of sale proceeds to him by the consignee.</td>
</tr>
<tr>
<td>5.</td>
<td>Advance against Undrawn Balance</td>
<td>Banks do finance against the undrawn balance, if undrawn balance is in conformity with the normal level of balance left undrawn in the particular line of export.</td>
</tr>
<tr>
<td>6.</td>
<td>Advance Against Claims of Duty Drawback</td>
<td>Duty Drawback is a type of discount given to the exporter in his own country.</td>
</tr>
</tbody>
</table>
4.00 **IMPORT TRADE**

Import trade is regulated by the Directorate General of Foreign Trade (DGFT) under the Ministry of Commerce & Industry, Department of Commerce, Government of India. Authorised Dealer Category – I (AD Category – I) banks should ensure that the imports into India are in conformity with the Foreign Trade Policy in force and Foreign Exchange Management (Current Account Transactions) Rules, 2000 framed by the Government of India vide Notification No. G.S.R.381 (E) dated May 3, 2000 and the Directions issued by Reserve Bank under Foreign Exchange Management Act, 1999 from time to time.

A Bank may act as an arranger for Buyer’s credit to the local importers. **Buyer’s credit** is the credit availed by an importer (buyer) from overseas lenders, i.e. banks and financial institutions for payment of his imports on due date.
5.00 REMITTANCES

5.01 INWARD REMITTANCES

Receipt of foreign exchange in India is called Inward remittance. Apart from exports there are other transactions, which generate inward remittance. For example Non-resident Indian staying abroad may remit foreign exchange to their relatives in India. Inward remittances are usually in the nature of foreign currency notes, foreign currency traveller cheques, foreign currency cheques / foreign currency demand drafts and inward telex transfers.

There are no restrictions on receiving remittances from abroad.

5.02 OUTWARD REMITTANCES

The term "outward remittance" means sale of foreign exchange in any form and includes not only remittances by T.Ts, M.Ts, drafts etc., but also sale of traveller’s cheques, traveller’s letters of credit, foreign currency notes and coin etc. Outward remittance can be made either by sale of foreign exchange or by credit to non-resident Rupee account of banks’ overseas branches or correspondents.

Authorized Dealer Banks are to be guided by the Rules made by the Govt. of India under section 5 of the foreign Exchange Management Act, 1999.

5.03 FORMS FOR REMITTANCES

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Name of Form</th>
<th>Particulars</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Form A 1</td>
<td>Application by person/firms/companies for imports amounts</td>
</tr>
<tr>
<td>2.</td>
<td>Form A 2</td>
<td>Application for payments other than imports and remittances covering intermediary trade</td>
</tr>
<tr>
<td>3.</td>
<td>Form A 3</td>
<td>Transfer of rupees from/to the account of a non-resident Bank other than transactions with the public in India</td>
</tr>
</tbody>
</table>
### 6.00 ACCOUNTS OF NON-RESIDENTS AND FOREIGN EXCHANGE ACCOUNTS OF RESIDENTS

<table>
<thead>
<tr>
<th>Type of Deposit</th>
<th>Nature of Deposit</th>
<th>Resident as Joint Holder</th>
<th>Repatriable</th>
<th>Currency in which account is denominated</th>
</tr>
</thead>
<tbody>
<tr>
<td>FCNR – Foreign Currency Non Resident</td>
<td>Term Deposit only</td>
<td>No</td>
<td>Yes</td>
<td>Foreign Currency only</td>
</tr>
<tr>
<td>NRE – Non Resident External</td>
<td>Saving, Current, Recurring, Fixed Deposit</td>
<td>No</td>
<td>Yes</td>
<td>Indian Rupees</td>
</tr>
<tr>
<td>NRO- Non Resident Ordinary Rupee A/c</td>
<td>Saving, Current, Recurring, Fixed Deposit</td>
<td>Yes</td>
<td>Yes, Conditionally</td>
<td>Indian Rupees</td>
</tr>
<tr>
<td>RFC- Resident Foreign Currency</td>
<td>Saving, Current, Recurring, Fixed Deposit</td>
<td>Yes</td>
<td>No</td>
<td>Indian Rupees</td>
</tr>
</tbody>
</table>

- Audited above accounts on the basis of RBI guidelines – amended from time to time.
7.00 FX DEALING / TREASURY OPERATIONS

• The cardinal principle of operational procedures in the area of trading activities is the clear functional segregation of Dealing, Mid-Office (Risk Management), Back-Office (Processing and Control), Accounting and Reconciliation.

• Forward Contract is an agreement between two parties to buy or sell an asset (of any kind) at a pre-agreed future point in time.

• Forward contract can afford adequate protection to importer or exporter against exchange risk.

• A bank account held in a foreign country by a domestic bank, denominated in the currency of that country called Nostro Accounts. The Nostro accounts are used to facilitate settlement of foreign exchange and trade transactions.
8.00 AUDITORS ROLE IN FOREIGN EXCHANGE TRANSACTIONS:

8.01 Export transactions

- In applications/correspondence with the Reserve Bank, the specific identification number as available on the GR, PP and SOFTEX Forms are cited.

- In the case of declarations made on SDF form, the port code number and shipping bill number is cited.

- After the documents have been negotiated/sent for collection, banks report the transaction to Reserve Bank in statement ENC under cover of appropriate R-Supplementary Return.

- In the case of exports made under deferred credit arrangement or to joint ventures abroad against equity participation or under rupee credit agreement, the number and date of Reserve Bank approval and/or number and date of the relative RBI circular should be recorded at the appropriated place on the GR Form.

- Randomly check the relevant duplicate forms (GR/SDF/PP) to ensure that non-realisation or short realization allowed, if any, is within the powers delegated to them or has been duly approved by Reserve Bank, wherever necessary.

- The number on the duplicate copy of a GR form presented to RBI is the same as that of the original which is usually recorded on the Bill of Lading/Shipping Bill and the duplicate has been duly verified and authenticated by appropriated Customs authorities.

- The Shipping Bill No. on the SDF form should be the same as that appearing on the Bill of Lading.

- In the case of contracts where the freight is sought to be paid at destination, that the deduction made is only to the extent of freight declared on GR/SDF form or the actual amount of freight indicated on the Bill of Lading/Airway Bill, whichever is less.
• The documents submitted to not reveal any material inter se discrepancies in regard to description of goods exported; export value or country of destination.

• Where the marine insurance is taken by the exporters on buyers’ account to verify, that the actual amount paid is received from the buyer through invoice and the bill.

• To accept the Bill of Lading/Airway Bill issued on ‘freight prepaid’ basis where the sale contract is on f.o.b. etc. basis provided the amount of freight has been included in the invoice and the bill.

• To negotiate the documents, in cases where the documents are being negotiated by a person other than the exporter who has signed GR/PP/SDF/SOFTEX Form for the export consignment concerned, after ensuring compliance with Regulation 12 of Foreign Exchange Management (Export of Goods and Services ) Regulations, 2000

• To accept the variations in the value declared to the customs authorities and that reflected on the export documents which stem from the terms of contract, on production of documentary evidence after verifying the arithmetical accuracy of the calculations and on conforming the terms of underlying contracts.

• Banks maintain Export Bills Register, in physical or electronic form. Details of GR /SDF/PP/SOFTEX form number, due date of payment, the fortnightly period of R Supplementary Return with which the ENC statement covering the transaction was sent to Reserve Bank are available.

• Banks should ensure that all types of export transactions are entered in the Export Bills Register and are given bill numbers on a financial year basis (i.e. April to March).

• The Bill numbers should be recorded in ENC statement and other relevant returns submitted to Reserve Bank.
• Banks furnish to the RO concerned of the Reserve Bank, on a half-yearly basis, a consolidated statement in Form XOS giving details of all export bills outstanding beyond six months from the date of export as at the end of June and December every year. The statement should be submitted in triplicate within fifteen days from the close of the relative half–year.

• In case of write offs of unrealized amount the auditor should check that the aggregate amount of write off allowed by the bank during a financial year does not exceed 10 percent of the total export proceeds realized by the concerned exporter through the concerned bank during the previous financial year, the relevant amount has remained outstanding for one year or more and satisfactory documentary evidence is furnished in support of the exporter having made all efforts to realize the dues;

8.02 General Checklist for Audit of Forex transactions

• Check the foreign bills negotiated under letters of credit

• Check FCNR and other non-resident accounts to see whether debits and credits are permissible under the rules

• Check inward/outward remittances have been properly accounted for

• Examine extension and cancellation of forward contracts for purchased and sale of foreign currency. Ensure that they are duly authorized and all necessary charges recovered.

• Ensure that overbought/oversold position maintained in different currencies are reasonable, considering the volume of foreign exchange operations.

• Ensure verification and reconciliation of Nostro and Vostro Account transactions/balances.
• Check foreign bill negotiated under letter of credit. Also check rates of conversion and whether the terms of letter of credit have been adhered to.

• As regards bill negotiated not under L/C also check necessary sanction has been obtained from corporate office.

• Check realizations of foreign bill for payments/foreign bill for collection (conversion rate), booking of income thereon and recovery of necessary charges. Ensure crystallization of FBPs on specified days as per FEDAI rules.

• Check outward bills are promptly dispatched and documents to title are drawn in favour of bank as consignee and not imported unless full payment is received by the bank.

• Prompt reporting of export/import/remittance transactions and forward contracts for sale/purchase of currency to treasury, which shall have impact on the currency position.

• Proper ECGC cover is taken for export advances like pre and post shipment advances or bank guarantees, unless expressly waived by Corporate Office.

• Ensure drawee wise limits set by ECGC are adhered and extension is sought when time limit exceeded.

• Check FCNR and other NR accounts to ensure debits and credits are as per rules.

• Check that inward and outward remittances are properly accounted and promptly reported to Corporate Office.

• Ensure that the system of daily vouching of FOREX transaction is in place.

• Ensure forward FX transactions are for the purpose of hedging genuine risks and are booked properly. All charges on cancellation or early delivery are recovered.
• Ensure that the foreign contributions are not credited to accounts of association/organizations unless they obtain registration or prior permission under FCRA 1976.

• BOE verification are done at half yearly basis.

• Check credit reports of overseas buyers/sellers for high value transactions (i.e. 1 lac and above)

• Returns and forms like R return, XOS, ENC, BEF, Form A1 etc. are filed with RBI in time.
## IMPORTANT RBI CIRCULARS

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Subject</th>
<th>Circular Reference</th>
</tr>
</thead>
</table>
| 1.     | Rupee / Foreign Currency Export Credit & Customer Service To Exporters | RBI/ 2012-13/74
        |                                                            | DBODNo.DIR.BC.06/04.02.002/2012-13 July 2, 2012                         |
| 2.     | Import of Goods and Services                             | RBI/2012-13/13 Master Circular No.13
        |                                                            | /2012-13 July 02, 2012 (Updated as on October 05, 2012)                |
| 3.     | Miscellaneous Remittances from India – Facilities for Residents | RBI/2012-13/6
        |                                                            | Master Circular No. 6/2012-13 July 2, 2012 (Updated as on October 12, 2012) |
| 4.     | Remittance Facilities for Non-Resident Indians / Persons of Indian Origin / Foreign Nationals | RBI/2012-13/8
        |                                                            | Master Circular No. 8 / 2012-13 July 02, 2012 (Updated as on October 12, 2012) |
| 5.     | Instructions relating to deposits held in FCNR(B) Accounts | RBI /2012-13/78
        |                                                            | DBOD.No.Dir.BC.8/13.03.00/2012-13 July 2, 2012                         |
| 6.     | Non-Resident Ordinary Rupee (NRO) Account                | RBI/2012-13/2
        |                                                            | Master Circular No. 2 /2012-13 July 2, 2012                           |