A Study on Compliance Levels for Preventing Financial Frauds with Special Reference to Public Sector Banks in India

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A Study on Compliance Levels for Preventing Financial Frauds with Special Reference to Public Sector Banks in India

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Abstract **- Finance is a very coined term used everywhere. Probably, few people understand the actual meaning of finance. It is not just money/cash/funds/capital. It is the flow of funds from the givers to the seekers in the society. A number of processing mechanisms do exist in India to translate and carry o this work. Banking is the most commonly used service vehicle for this purpose. When the flow of funds happens through banking, due to mis management or poor internal check and control, there may be instances of frauds in financial activities of bank. The frauds happening via or in banks have a huge impact on entire banking sector thus leaves the question of reliability on banking system. Perhaps, RBI has given many compliance procedures also to be followed while attending a financial transaction in a bank, but still the frauds are continued in happening. Surprisingly, the lower level to top level staff is highly involved in these scams. The financial frauds that are coming out on consistent basis will result into the slow pace of growth of Indian economy. The present paper tries to discuss the impact of financial scams and the compliance procedures followed by the staff at public sector banks. The paper brings out some interesting recommendations/findings from the study.**

Keywords: Financial Frauds, Level of Defence, Employee Involvement, Compliance Levels.

I. INTRODUCTION TO BANKING

The first western bank of Joint stock verity was Bank of Bombay established in 1720. This was followed by bank of Hindustan in 1770 and General Bank of India in 1786. Later, all these banks were closed in 1932. In 1806, bank of Bengal, the first Presidency Bank was established with a capital of Rs 50 Lakhs of which Government subscribed 20% of capital. The Bank of Bengal was given powers to issue currency notes in 1823. Later in 1840, bank of Bombay was established with a capital of Rs 52 lakhs. In 1843, Bank of Madras established with a capital of Rs 30 Lakhs. All these banks were governed by Royal Chapters. The first Indian owned Joint stock banks were Allahabad Bank in 1865. But before this in 1863, Bank of Upper India was established and then failed in 1913.Later Punjab National Bank was established in 1895 at Lahore and then Bank of India in Mumbai in 1906. The three Presidency banks were amalgamated into single banks as “Imperial bank of India” in 1921. Imperial Bank of India was further reconstituted with number of banks belonging to states of Jaipur, Mysore, Patiala and Jodhpur. Till establishment of Reserve Bank of India in 1935, Imperial bank of India functioned as Central Bank of India discharging the function of commercial banking, Central bank and Banker to Government. The great depression during 1928-1934 had severely affected the baby growth of Indian banking sector. So many banks were closed during these periods due to Internal and External reasons.

When India got Independence, except Imperial Bank of India, almost the sector is in Private hands. There are five big banks, namely Central Bank of India, Punjab National bank, Bank of India, Bank of Baroda and United Commercial Bank Ltd each holding public deposits of Rs 100 crores and above. The Government of India has initiated the measures to play an active role in the Economic life of Nation and the Industrial policy resolution 1948 implemented the Mixed Economy strategy for India. A major move was that RBI was established under the terms of RBI (Transfer to Public ownership) Act, 1948. In 1949, Banking Regulation Act was enacted which exposed the RBI to regulate, control and inspect the banks in India. The banking Regulation Act has provided that without license from RBI, no new bank or branch should be established in India.

The Imperial bank of India was mainly urban oriented and completely ignored the remote and rural areas. So in the need of the hour, Imperial Bank of India was suggested to extend its operations to Taluks/Panchayats and it was given a target of 114 branches by 1955 in the year 1951. But the Imperial bank had opened only 63 branches till 20th June 1955. So as a matter of reforms and regulation, Imperial Bank of India was taken over by Government of India under State Bank of India Act, 1955 with effect from 01/07/1955. And then State Bank of India (SBI) was started.

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1.1 Concept of Fraud

In the recent years, it can be seen that there is large amount of frauds happening in banking sector. A fraud as defined by RBI, "A deliberate act of omission or commission by any person, carried out in the course of a banking transaction or in the books of account maintained manually or under the computer system of accounts, resulting into wrongful gain to any person for a temporary period or otherwise with or without monetary loss to the banks"

Fraud in financial services sector poses a significant risk to institutions and veracity of capital markets. It effects can be widespread and cause not only long term financial but also reputational damage. According to the survey in financial sector is most vulnerable to fraud as compared to other sectors. Moreover, the cost of fraud does not stop at a monetary figure; it is deceptive in nature, has other serious implications including.

1.2 Types of Frauds

- Stolen cheques
- Cheque kitting
- Forgery and altered cheque
- Accounting frauds
- Demand draft fraud
- Fradulent loans
- Forged documents
- Wire transfer frauds
- Payment frauds
- Phishing and internet frauds
- Money laundering

1.3 Frauds in Indian Banking Sector

Banking, being one of the most necessary things in the lives of individuals and businesses and every financial activity is being backed up by the banking directly or indirectly and thereby resulting into economic growth. The financial assistance and services provided by bank to all sectors of economy is remarkable and appreciable. In the recent years, it can be seen that there is large amount of frauds taking place in the economy, especially in banks. As per the RBI annual report 2019-20, the following are the quantum of frauds reported in different years.

Table 1: Amount of Financial Frauds in Indian banking sector during 2017-2020 (Rs in Crores)

Banking Group	2017-2018	2018-2019	2019-2020
Public banks	38,260	63,283	14,840
Private banks	2,478	6.742	34,211
Foreign Banks	256	955	972
Financial Institutions	164	553	2,048
Small Finance Banks	6	8	11
Payment banks	0.90	2	2
Local Area Banks	0.04	0.02	0.4
Total	**41,167**	**71,543**	**1,85,644**

Source: RBI Annual Report 2019-2020

From the above table, it is clear that the quantum of frauds has been increasing at a very rapid rate from the last 3 years. We can see a rise of 350% from 2017-18 to 2019-20 in total frauds amount in all banks. Out of 1,85,644 crores of frauds in 2019-2020, the number of cases are more than 1,00,000. 98% of the total frauds are in advances only. Also, the public sector banks contributed 80% of total frauds and balance is contributed by private banks and other financial institutions.

Table 2: Frauds in Public Sector banks during April- June 2020

Name of the Bank	No.of Cases	Amount of Fraud (In crores)
State Bank Of India	2,050	2,325.88
Bank Of India	47	5,124.87
Canara Bank	33	3,885.26
Bank Of Baroda	60	2,842.94
Indian Bank	45	1,469.79
Indian Overseas Bank	37	1,207.65
Bank Of Maharashtra	9	1,140.37
Punjab National Bank	240	270.65
Uco Bank	130	831.35
Central Bank Of India	149	655.84
Punjab &Sindh Bank	18	163.33
Union Bank Of India	49	46.52
Total		**19,964**

The above table clearly indicates that Bank of India, Canara Bank and Bank of baroda has witnessed the large amount of frauds during the first quarter of 2020 followed by SBI at a major share. However, it can be noticed that Punjab National bank has shown a very less amount of fraud with more number fradulent cases.

II. RESEARCH DESIGN

2.1 Statement of the Problem

The studies which were conducted earlier on the financial frauds of public sector banks have confined to various empirical studies only and they do not bring about the compliances with RBI guidelines by the staff of the banks from lower level to top level. If we observe the series of frauds took place in the last 10 years, it can be concluded that without involvement of the staff/managerial persons, the chances for possibilities of fraud is very less. From the fraud of Bipin Vohra in 2014 who cheated Central bank of India with forged documents of 139 crores to the latest Nirav Modi scam which involved 14,000 crores with PNB proved that either the negligence of wilful involvement of the employees lead to

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fradulent practices. The present paper tries to study the compliance of the employees in all levels to RBI guidelines from time to time to identify and prevent the frauds in banks.

2.2 Objectives of Study

- The study wants to bring the quantity and quantum of financial frauds in Indian banking sector with special reference to Public Sector banks.
- The study also wants to narrate the mechanism of how the line of defence exists in the banks in checking and controlling of frauds
- The study is aimed to analyse the compliance levels of the bank employees to different guidelines and standards given by RBI from time to time in preventing the frauds.

2.3 Sampling Size and techniques

The present study highlights three public sector banks which are in top in Public sector banks domain, viz., State Bank of India, Punjab National Bank & Bank of Baroda. 200 employees at different levels (Clerk to Manager) from these banks in Chittor, Nellore and Kadapa district regions were surveyed with regard to the study.

Questionnaire method has been used and the percentage analysis was used in finding the outcomes of the study. The study has taken nearly 2 months to collect the data.

2.4 Sources of Data

Primary Data: This kind of study needs Primary data for analysis. As stated above, the primary data was collected through questionnaires. The responses were collected personally and through Google forms. In some of the branches, personal interviews and discussions were held with the employees to understand the level of compliance levels.

Secondary data: Secondary data was taken from RBI website, annual reports and related web sources of banks etc.

III. LINE OF DEFENCE IN BANKS

Every bank, to process any financial transaction, has a specified line of defence to have more internal quality and control. It is very normal and general that every organization should have a better internal check and control to ensure the proper processing of the transaction. For example, if the cashier makes payment to the customer, the voucher should be authorized by the Officer, by signing on the voucher and then the transaction has to be passed manually and digitally.

Usually, line of defence in a bank, will be of three stages

1. Dual control
2. Books/Accounts section
3. Audit

Dual Control is the mechanism where every transaction has to be verified by another employee who may be superior to the former who records the transaction. The signatures and passwords have to be properly verified and accordingly a counter signature to be made the verifying officer to approve the same.

Books/Accounts Section is the EOD mechanism (End of Day) where all the transactions on a daily basis will be counter verified from the records and vouchers. This practice will be meticulously followed whenever there is dis-tally of cash in the cash counters.

Audit is final stage of checking of transactions. Before going for external audit, the bank will appoint an internal officer who will check the records and accounts. Later, after finalization of financial statements, an external auditor will be appointed to audit again all the transactions with complete secrecy and independence. For Public sector and Scheduled Commercial banks, RBI will appoint an auditor who audits the reports of Internal and External auditors randomly.

IV. DATA ANALYSIS AND INTERPRETATION

Table 3: Compliance Level of bank Managers about various heads of operations

Internal Control & Audit	Loans and Advances	Deposits	Administration of Cheques/Passbooks	Demand Drafts	Inter Branch Operations
92%	90%	79%	60%	84%	63%

Source: Field Study

The above table clearly indicates that most of the bank managers are well aware of compliance levels with regard to internal control and audit mechanisms. 60% of the Managers are only aware about the compliance levels of the administration of cheques and passbooks in the counter.

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Table 4: Attitude of Bank Employees towards RBI Procedures with regard to prevention of frauds

Favorable		Moderate		Unfavourable	
Number of Respondents	%	Number of Respondents	%	Number of Respondents	%
30	15%	46	23%	124	62%

Source: Field Study

The above table indicates that most of the employees are not favoring the RBI procedures given for prevention of frauds. Very few (15%) of the employees are favor to the implication of RBI procedures.

Table 5: Level of awareness of the bank employees about frauds involved by staff in various banking frauds

	High	Medium	Low	Total
Managers	4 (20%)	6(30%)	10 (50%)	20
Officers	14 (23%)	24 (40%)	22 (37%)	60
Cashiers	10(14%)	20 (28%)	40 (52%)	70
Clerks	6 (12%)	18 (36%)	26 (52%)	50
TOTAL	**34**	**68**	**100**	**200**

Source: Field Study

The table about the level of awareness of bank employees involving in frauds gave shocking results that most of the top (Managers at 50%) and Lower level (Clerks at 52%) are not aware of the frauds in which bank staff are involved. This clearly shows that employees are not updating themselves with regard to the happenings in their organization also.

Table 6: Following of RBI Circulars and drafts with regard to Compliance Procedures of Frauds in banks

	YES	NO	OCCASSIONALLY
No. of Responses	54 (27%)	88(44%)	58 (29%)

Source: Field Study

The above table mentions that most of the employees (44%) are not following the circulars/drafts issued by RBI with regard to compliance procedures to be followed for prevention of frauds.

Table 7: Analysis of Various reasons for Occurrence of Frauds

	No Training	Corrupted Officer in Charge	Over Burden of work	Competition	Family Pressure	Total
Managers	8	3	6	1	2	20
Officers	22	12	11	10	5	60
Cashiers	35	10	17	5	3	70
Clerks	20	5	8	11	6	50
	85(43%)	**30 (15%)**	**42(21%)**	**27 (13%)**	**16 (8%)**	**200(100%)**

Source: Field Study

Some interesting facts can be drawn from the above table where most of the employees are of the opinion that lack of training (43%) is the main reason for the frauds in banks. This opinion is followed by over burden of work (21%) among the employees which make them to cross the line of defence some times.

V. FINDINGS OF THE STUDY

The following are the different outcomes of the study which are framed as below:

- The compliance levels of the various aspects by the Managers is understood that most of the managers are complying with the Internal control and audit procedures but they do not have more knowledge about the administration of cheques/ pass books.
- Most of the bank employees are not favourable to the guidelines issued by RBI from time to time in prevention of frauds.
- Most of the Managers and Clerks do not have any idea about the involvement of staff in various banking frauds.
- It is difficult to detect the fraud in time and also more difficult to book the offenders due to complex/lengthy judicial requirements in the process.
- Delay in detection and reporting to the regulatory and inspection agencies and the action taken against the fraudsters is also causing the concern.
- Most of the employees are of opinion that due to lack of training, the frauds are multiplying in the banks
- Also, more number of employees are not properly following the circulars/guidelines issued by the RBI

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from time to time in defining and detection of frauds in banks

- Most of the employees feel their job as secured and safe and so not aware of the punishments/consequences of the fraudulent practices, if proved.
- In some of the branches, the staffs are well aware that the ex-employees were removed from service due to their involvement in fraudulent practices earlier.
- Over burden of work is also one of the reasons for the staff involvement in the financial frauds.

VI. SUGGESTIONS

- The Bank Managers should be well aware of the all practices and administration procedures to be followed in banks
- The staff should be given adequate training with regard to identification of frauds and consequences if involved in fraud.
- The branch managers should make all the staff to read the circulars from RBI from time to time and keep them updated.
- An open meeting of discussions should take place with regard to any frauds happened in any bank. The staff should discuss and understand the compliance procedures.
- Bank employees should take more care while lending the loans. They should also give equal importance to various heads of transactions.
- It is also important for KYE (Know Your Employee). Extra due diligence is required while recruiting the employees.
- The staff should be made well aware of the frauds that are happening in the economy by displaying the same on notice boards, presentations etc.
- RBI needs to develop a frame work in such a way to detect the frauds immediately.
- Banks should take severe complaints against the fraudsters by lodging the complaints against them.
- The risk management system to be improved.
- Need to create the awareness among the customers also by addressing them about the various banking frauds and its impact on the economy.

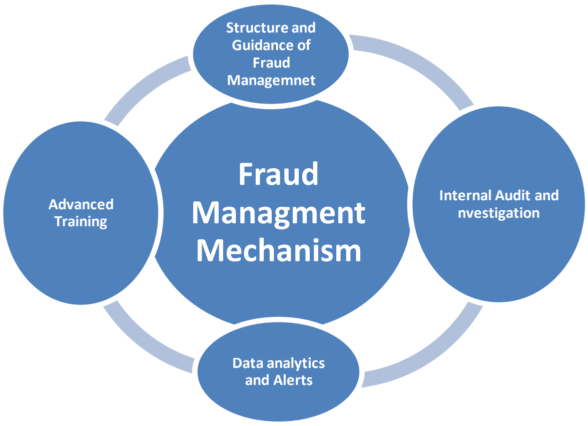

Figure 1: Fraud Management Mechanism in Banks

VII. CONCLUSION

While banking finds more growth over a period of time, so as the frauds also. The number of fraud cases are increasing and the quantum of these cases show a very alarming signal for strict guidelines and prudence laws. It not only decreases the growth of the banks, but also has a huge impact on growth of the economy due to increase in Non Performing Assets also (NPA). Infact, fraud is something which no organization wants to deal with but it should be given more importance to prevent the employees are the key people to create the fraud and also to stop it. So, they should be given clear awareness regarding the procedures to be followed in fraud administration mechanism and also they should adhere to the compliance procedures given by RBI from time to time in prevention of frauds and scams.

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