

Frauds in Banks

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Frauds – sec 447(1)

- Act omission or concealment
- Of any facts
- Abuse of position
- Connivance
- Deceive or gain undue advantage
- Injurious to interests
- Company – shareholders – creditors – others
- Whether wrongful loss is caused or not

Frauds – Sec143(12)

- Reporting of fraud
- Manner & timelines prescribed
- Central Govt over a threshold
- Audit committee below the threshold
- Disclosure in Boards report
- Penalty of 1-25 lakhs for non compliance
- Does not affect confidentiality if reporting is done in good faith

Sec 17 – Contract Act

- Includes the following acts –
- Suggestion of facts which is not true made by one who does not believe it to be true
- Concealment of facts
- Promise made with no intent to perform
- Fitted to deceive
- of commission – omission which the laws specifically consider as fraudulent

SA 240 – Auditor responsibility

- Identify & assess risk of MM in FS
- obtain appropriate evidence on risks identified
- Respond appropriately to suspected frauds
- Fraud risk factors to be identified by TCWG
- MM, fraudulent financial reporting, asset appropriation - management override
- Communication of ethical behaviour
- Documentation of actions taken wrt fraud

Fraud Theory

- Fraud Triangle – Opportunity, Pressure, rationalization
- Fraud Diamond – Capability
- Fraud Circle – wherever there is money
- 80-10-10 Theory
- Men Rea – Guilty Mind
- Oops Theory of Defence
- Cockroach Theory – Popcorn Theory

Controls

- Prevent – Detect – Control – Act
- Automated – Pro-active – Deterrent –
- Maker checker
- Job rotations
- Mandatory leaves
- Physical verification
- Reconciliations – Confirmations
- Authorization – Audits

Causes of Frauds

- Weak control design – implementation
- Poor tone at the top - Lack of ethics
- Absence of management review
- No competent oversight
- Poor training – awareness
- Pressure of targets – mis-selling , manipulation
- Greed – Need – Fun – Revenge
- Poor deterrent action – tardiness of legal system
- Skewed cost benefit ration in fraudster's favour

Do's

- Fraud structure – policy – committee – officers
- Fraud registers - Anti fraud controls
- Ethics culture
- Fraud reviews – audits
- Vigilance function
- Life style audits
- Exit interviews
- Terminations on the spot
- Zero tolerance policy

Master Circulars

1. Master circular on detection & impounding of currency notes – July 1st, 2019

- Failure to impound counterfeit notes considered as willful involvement that will invoke penalty
- Filing of FIR if 5 or more pieces of notes are found in a single transaction
- Monthly consolidated report shall be sent to the Forged Note Vigilance Cell of H.O
- Provision of Ultra-Violet Lamp and Other Infrastructure
- Detection of Counterfeit Notes - Training of Staff

2. Master circular on Mobile Banking Transactions –July 1st, 2016

- **Transaction limit** based on the bank's own risk perception
- **Customer Complaints and Grievance Redressal Mechanism**
- Risks involved
 - Unauthorized transactions through hacking
 - Denial of service,
 - Breach of secrecy & confidentiality – bank to take necessary protective measures, including insurance

3. Master Circular on Frauds – July 1st, 2016

- Classification of frauds
- Central Fraud Registry- web-based and searchable database; issuance of Caution Advice on frauds & attempted frauds having systemic implications
- Return of Frauds-penal action for delays in submission of returns
- Flash Report (FR) for frauds involving amounts of ₹ 50 million and above within a week
- Board reporting – quarterly & annual review by audit committee –contd.

Aspects to be taken into account in Board review

1. System adequacy to detect frauds in the shortest possible time
2. Staff accountability
3. Deterrent punishment
4. Laxity in adherence to systems -processes to be plugged
5. Reporting to police / CBI

3. Master Circular on Frauds – July 1st, 2016

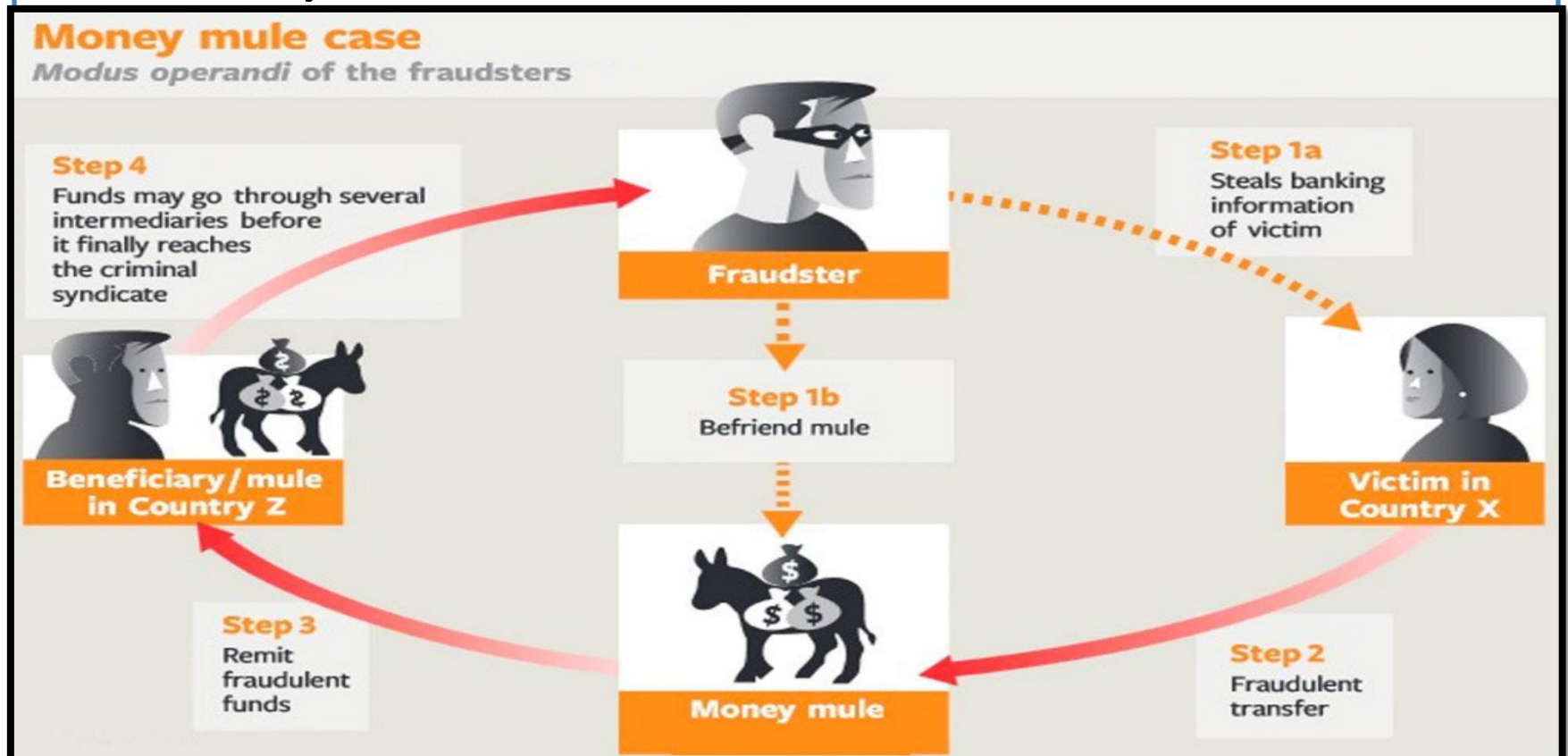
- Special committee of Board to review frauds over 1 Cr.
- Cheque Related Frauds-Precautions
 - Examining from UV lamp cheque over 2L
 - multiple checks over 5L
 - SMS alerts
- **42 EWS – RFA**
 - Reporting to CRILC over 50 Crs.
 - EWS to be classified as RFA within 1-6 months
 - RFA to Fraud or removal as RFA within 6 months
 - may use external auditors or forensic experts
 - Forensic audit to be completed within 3 months

3. Master Circular on Frauds – July 1st, 2016

- Investigations during the different stages of the loan life-cycle should be carried out:
 - Pre sanction
 - Disbursement
 - Annual Review
- Staff empowerment-whistle blower
- Role of Auditors-notice of top management – audit committee
- Incentive for Prompt Reporting-provisioning for frauds over 4 quarters
- Legal Audit of Title Documents of all loans over 5 Crores
- Reporting Cases Of Theft, Burglary, Dacoity And Bank Robberies-submit a quarterly Return
- Closure of Fraud Cases

4. Master circular on KYC - AML - CFT – July 1st, 2015

- Beneficial ownership
- Money Mules



4. Master circular on KYC - AML - CFT – July 1st, 2015

- KYC POLICY should incorporate
 - Customer Acceptance Policy.
 - Customer Identification procedure.
 - Monitoring of Transactions.
 - Risk Management.
- Shell correspondent Banks
- Recommendations of FATF
- PMLA Rules
- Freezing of assets under Unlawful Activities (Prevention) Act, 1967, (amended on 31.12.2008)
- Filing of STR to FIU

5. Master circular on Willful Defaulters - July 1st, 2015

- Banks required to submit to RBI the details of the willful defaulters $\geq 25L$.
- Diversion and siphoning of funds
- End use of funds-not depend entirely on the certificates of CA
- Mechanism of identification of willful defaulters
- Criminal Action against Willful Defaulters
- Disciplinary action against CA for falsification of accounts – non consideration for future engagements.
- Information to be available to the banks / FIs on a near real time basis.

6. Cyber Security Framework in Banks – June 2nd, 2016

- Cyber security policy separate from IT policy
- IT architecture conducive to security
- Identification & classification of information assets
- Cyber security preparedness indicators
- Cyber crisis management plan
- BCP-DR
- Social media risks
- Policy for IT services outsourcing
- Incident management monitoring & reporting
- Gap assessment
- Cyber security awareness
- Trails - PKI

Cyber Security Controls

- Prevent usage of unauthorized software
- Network management & security
- Secure configuration
- Patch vulnerability – change management
- Use access control
- Secure mail & messaging systems
- Data leak prevention strategy
- Advance real time threat defense
- VAPT & red team exercises
- Anti-phishing
- Authentication framework

practical issues

NPA divergence

Draw power variances – inflated stock statements

Inflated Valuations

Frequent TODs

Related Party & Cash transactions

Financial statement manipulations

Incorrect information – padded estimates

Conflict of interest situations

Forged documentation

Non-existent security

other issues – future

- AI, ML, Block Chain, Cloud Computing, Big data analytics
- Data – information – knowledge – wisdom
- Hindsight – Insight - Foresight-
- Regulatory sandbox
- disclosure, light touch, tight regulation, full-fledged supervision
- Mobile & web based applications
- Digital Currencies
- Peer to peer lending – Crowd funding
- Robo –advisors
- E-aggregators