Studying the Issues Faced in Commercial Bank Branch Operational Related Fraud Management

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Abstract— Bank Branch Operational Related Frauds are common to any Commercial Bank. This study therefore focused on studying the issues faced in Branch Operational Related Frauds with special reference to Internal Controls, Operational Risk Management, Internal Audit Methodologies, and Staff Ethical Behaviour / EOHR. Accordingly, the study has been conceptualized by identifying the Branch Operational Related Fraud Management as the Dependent Variable and four independent variables as Internal Controls, Operational Risk Management, Internal Audit Methodologies, and Staff Ethical Behaviour / EOHRM. Further, this study adopted a mixed method approach with quantitative and qualitative analysis. Under the quantitative chapter, univariate, bivariate, factor, reliability, sample adequacy and parameter analyses were done. The macro view of the Parameter estimate established that the Operational Risk Management is the most Significant Independent Variable to the Dependent Variable of Branch Operational Frauds. Also the macro level second most Independent Variable to the Dependent variable is Staff Ethical behaviour and EOHR. Besides, the micro view of the parameter findings established that RCSA process and HR Efforts are the most significant indicators which could minimize Frauds. On the other hand, the bivariate analysis has evidenced that the relationships between the Branch Operational Related Fraud Management have a negative significant relationship with all the Independent Variables. To establish reliability, the Cronbach's Alpha coefficient values were analysed, and it states that there is an internal consistency among the variables, and the KMO test states the sample size is adequate. The qualitative analysis of the study was a thematic analysis and these findings were able to back the quantitative findings.

Keywords— frauds, controls, risk, audit, HR

I. INTRODUCTION

A. Background of the Study

A Bank mainly mobilizes the financial resources of a country and canalizes them into productive lines of investments. Therefore, a Bank can be identified as a back born of an economy in a country. Collapse of one Bank in a country may result in collapsing the other Banks in the Banking Industry of that country which may have serious repercussions to the entire economy. Central Bank of Sri Lanka acts as the regulator for banking sector which regulate, monitor and authorize in carrying out Banking business in a prudent manner.

Branch Operational Related Frauds are being reported in every year in every Commercial Bank in Sri Lanka despite the fact of implementing robust Internal control systems, best Operational Risk Management practices, Effective Internal Audit Methodologies, and Efforts of Human resources Departments to establish Ethical culture in banks. In all most every fraudulent incident in a Bank, a Branch staff member had either directly involved in carrying out these Frauds or they have abated to it. A dis honest Bank Staff member could play havoc with Banks funds. These Frauds can be categorized as Insider frauds (Banker's Bunks). Therefore, the Banks has to guard itself and its customers against the dishonest Bank employees. It can be observed that there are two principal methods of getting something from others illegally. One way is physical force and the other way is by trickery. The first type of theft is called robbery and the second type is Fraud. A robbery generally seems to be violent and more traumatic than a fraud and attracts more media attention however losses from fraud far exceed losses from a robbery. Generally, Fraud involves deception, confidence and trickery.

Branch Operational Fraud is different from unintentional operational errors which are made by the Branch Banking Operational staff. As an example, if a Branch Teller credit incorrect deposit to a customer accounts it cannot be considered as an operational fraud, because it had not been carried out with intent or for the purpose of gaining advantage over another through false pretense. On the other hand, if a Teller purposely debits a customer account to trick the customer and use those funds for his personal benefit, then it is a Fraud!

B. Research Questions

Following Research questions are developed to address the problem statement.

i.   What are the Internal Control gaps/weaknesses in Branch Operations which may lead to Frauds?

ii.   How Operational Risk Management mechanisms could prevent Operational Frauds in Branch Banking Operations?

iii.   How the Business Lines prevent Operation related Frauds via creating awareness among staff with regard to Internal Controls?

iv.   What is the best practical method in conducting Audits of Branch Banking Operations in a prudently accepted manner to identify the control weaknesses to mitigate Branch Banking Operational related frauds?

v.   How the Bank Staff Ethical Behavior / Ethical Orientation of Human Resource Management could contribute to minimize Branch Operation related Frauds?

C.   Research Objectives

1) Core Objective

Studying the issues facing in Branch Operational Related Fraud Management with special reference to Internal Controls, Operational Risk Management, Internal Audit Methodologies and Staff Ethical Behavior & Ethical Orientation of Human Resource Management.

2) Secondary Objectives

In order to identify the above core objectives, the following secondary objectives are developed.

i.   To explore the Internal Control gaps/weaknesses in Branch Operations which may lead to Frauds prevailing in the Branch Operations?

ii.   To identify proper Operational Risk Management mechanism to combat Operational Frauds in Branch Banking Operations?

iii.   To assist the Business Lines to prevent Operation related Frauds while embedding ethical criteria to the Branch Network and thereby creating awareness among staff with regard ethical behavior?

iv.   To analyze the best practical method in conducting Branch Audits in a prudently accepted manner to identify the control weaknesses to mitigate Branch Banking Operational Related Frauds?

II. METHODOLOGY

A.   Conceptual Framework

Based on the hypothetical behavioral pattern, the proposed conceptual framework is depicted in Figure 01 below.
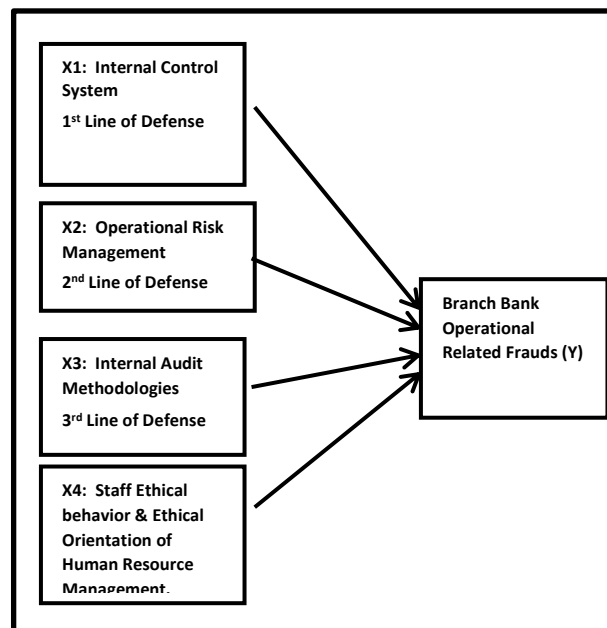

Figure 1: Conceptual Framework

Source: Developed by Author 2020

B.   Formulation of Empirical Model

The formulation of the empirical model of the research was developed based on the conceptual framework of the study as shown below.

$$Y_{ij} = f(X_{1ij}, X_{2ij}, X_{3ij}, X_{4ij},) Err,$$

Where:

Y = Vector of Operational Related Frauds

X1 = Vector of Internal Controls

X2 = Vector of Operational Risk Management

X3 = Vector of Audit Methodologies

X4 = Vector of Staff Experience with regard to Fraud Risk Management

i = Of a Bank

f = of NDB CBank

Err = Error

C. Sample Profile

This study is having a mix approach with qualitative aspects and quantitative aspects and for qualitative aspect five staff members are selected on judgmental sampling method. Besides, for quantitative aspect 100 respondents are selected by using convenience sampling methods. For judgmental sampling researcher had categorically selected Internal Audit Department of NDB bank PLC and its Branch Network Management since the staffs attached to the Internal Audit Department of NDB bank PLC and Branches are the people who can provide best information to achieve the objectives of the research.

D. Data Collection Method

This study is a mix study, with qualitative and quantitative approaches. For quantitative data collection method, semi structured questioner method will be used while for qualitative data collection method researcher will adopt the Interview method since Interviews can be used as a primary data gathering method to collect information from individuals about their own practices, beliefs, or opinions. Further, these can be used to gather information on past or present behaviors or experiences.

E. Data Analytical Method

The quantitative data will be analyzed under Univariate, Bivariate and multinomial data analytical methods. Further, the researcher under the multinomial data analytical method intends to carry out the reliability testing, validity testing, Factor analysis and Parameter Estimates. Besides for the Qualitative data analytical method the researcher will carry out a thematic analysis.

III. DISCUSSION AND ANALYSIS

A. Results

1) Bi Variate Analysis

In order to establish the relationships between each Independent Variable and the Dependent Variable, bivariate analysis has been carried out by using SPSS Version 22. The study has adopted Pearson's correlation coefficient for the analysis and it was noted that the relationship between all the Independent Variables to the Dependent Variable were negative and it is significant.

2) Univariate Analysis

In univariate analysis it was observed that the respondents have agreed for all Independent Variables. However, it has been observed that for the Dependent variable the respondents have disagreed.

3) Sample Adequacy

The Kaiser-Meyer Olkin (KMO) and Bartlett's Test measure of sampling adequacy is used to test the suitability of Factor Analysis.

Table 1. Sampling Adequacy- KMO and Bartlett's Test

KMO and Bartlett's Test		
Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.835
Bartlett's Test of Sphericity	Approx. Chi-Square	144.161
	df	10
	Sig.	.000

Source: Survey Data 2020

According to the Table 1 The approximate of Chi-square is 144.161with 10 degrees of freedom, which is significant at 0.05 Level of significance. The KMO statistic of 0.835 is also large (greater than 0.50). Hence Factor Analysis is considered as a suitable method for further analysis of the data.

4) Reliability Test

The Cronbach's Alpha coefficient had been used in order to measure internal consistency and varies between 0 and 1 and the cut-off point is 0.6.

According to Sekaran (2003) the acceptable value of alpha should be about 0.60. In general, reliabilities less than 0.60 are considered to be poor, those in the 0.70 range is acceptable, and those over 0.80 is considered as good. The test has been conducted through SPSS (version 22) for measuring the internal consistency of the instrument, based on the average inter-item correlation. The result of Cranach's alpha test of each variables and results are shown in Table 2.

Table 2. Realiability Test

Variable	Cronbach's Alpha
Internal Controls	.835
Operational Risk Management	.704
Internal Audit Methodologies	.740
Staff Ethical Behaviour & EOHR	.621
Branch operational Related Frauds	.752

Source: Survey Data 2020

The Cronbach's Alpha coefficient values for all variables are above the limit point 0.6 this indicates an acceptable internal consistency among the variables. Therefore, the variables used were concluded as reliable.

5) Parameter Estimates

The holistic view of the parameter estimate of this study had been presented by analyzing the parameter estimates of all four Independent Variables (Internal Controls, Bank Operational risk Management, Internal Audit methodologies, Staff Ethical Behavior & EOHR) has been depicted in Table 4.

Table 3. Parameter Estimates

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	287.294	34.876		8.238	.000
	Internal Controls	-.243	.216	-.138	-1.127	.265
	Operational Risk Management	-.832	.382	-.320	-2.179	.034
	Internal Audit Methodologies	-.405	.450	-.147	-.901	.372
	Staff Ethical Behavior & EOHR	-.599	.292	-.260	-2.049	.045

Source: Survey Data 2020

The rule of thumb which has been adopted to determine the significance level is if the significance level is below .05 it is significant. Therefore, according to the Table 3 it can be stated that Operational Risk Management is the most Significant Independent Variable to the Dependent Variable of Branch Banking Operational Fraud Management. Besides, Branch Operational Risk Management and Branch Operational Related Fraud Management are inversely related by -.832 odds with a significance level of .034.

On the other hand, the second most significant Independent Variable to the Dependent variable is Staff Ethical behavior & EOHR. According to the Table 4 the significance level is .045. As such it could be concluded that Staff Ethical behavior & EOHR and Branch Operational Fraud Management are inversely related by -.599 with a significance level of .045.

6) Factor Analysis

Factor analysis has been carried out to identify the strongest factors and the weakest factors of the individual indicators / variables that are presented under all. Independent Variables and the Dependent Variable. Initially the researcher had carried out a factor analysis for the individual indicators in order to get an understanding of the strongest factors and the weakest the factors of the specific Variable. Thereafter, to observe a holistic view under the factor analysis same has been further extended for each Individual Variables which are presented under specific Independent and Dependent Variables.

Factor analysis of the four Individual Variables that are analysed under Internal Conrtols reflected that Supervisiory Controls in Branch Operations is the strongest factor. At the same time factor analysis of Operational Risk Management established that both variables Risk and Control Assessements and Fraud Prevention Policy depited under OPM are equally strong factors. Similarly, with regard to

Bank different Audit Methodologies discussed two variables namely Risk based Audits and Cycle based Audits and the study established both these are equally strong factors. Factor ananlysis of Staff Ethical Behaviour and EOHR revealed that HR efforts and selecting right caliber of staff both the variables are also equally strong factors.

7) Qualitative Analysis

The qualitative analysis of this research is based on the data collected through personal interviews with five different respondents. This qalitative analysis has been carried out using thematic approach. In accordance with the objectives of this study the qualitative analysis was aimed to identify the relationship between Branch Operational Related Fraud Management with Operational Risk Management, Internal Controls, Internal Audit Methodologies, Staff Ethical Behavior and Ethical Orientation of Human Resource.

Then the analysis started manually with the use of transcripts. Upon careful perusal of these transcripts the researcher has identified five main themes under which the respondent's answers are falling. Finally, it was thematically established that the Branch Operational Related Frauds could reduced via Stregthening the Internal Controls, Deploying Proactive Branch Operational Risk Management, Implementing Internal Audit Methodologies and also by enhancing the Staff Ethical Behavior via HR efforts. Further, it is thematically agreed by all the respondents who are well experienced Bankers that the RCSA needs to be strengthened to minimize Branch Operational Related Frauds. On the other hand, they strongly agreed that staff ethical behavior is a must to prevent Frauds. Therefore, the qualitative analysis has backed the quantitative analysed data of the study.

B. Discussion

Branch Operational Related Fraud Management had been a major challenge in today's context in Banking Industry. The Banks have heavily invested in strengthening the Internal Controls, Establishing the Operational Risk Units with robust technology and deploying experienced well trained qualified staff in order to Manage Operational Frauds. At the same time Internal Audit Methodologies are also available in Banks to evaluate the effectiveness of Internal Controls. On the other hand, the HR of

Banks make efforts to embed ethical culture into Branch Banking.

This study parameter estimate has specifically identified that the Bank Risk and Control Self-Assessment (RCSA) process and the Branch Operational Fraud Management is inversely related by -2.275odds with significance of p.000. At the same time the Operational Risk Management and Bank Operational Fraud Management are also inversely related by -.832 odds with significance of p.034.

Therefore, strengthening of Branch RCSA process is a must to manage the Branch Operational Related Frauds. The RCSA is a structured mechanism for a business lines to then and there identify and assess the Operational Risk and this is facilitated by the Operational Risk Unit. The main key processes in Branch Operations include Cash, ATM, Account Opening, Fixed Deposit Upliftments, Dormant Account Reactivations, marking liens, Issuance of Instruments such as Cheque Books, Cards, PINs, Drafts, TOD/Excess accommodations, Pawning etc where a Fraud could happen at any time. Therefore, to strengthen the RCSA a proper ground level identification of RCSA scope/effectiveness by the ground level stakeholders categorically needs to be establish and this must be facilitated by Operational Risk who has the expert knowledge via Monitoring, Analying, Studying of Existing Controls, Assessment of Control Effectiveness, apart from rootine assessments of frequency of Frauds, Impact of Frauds, Tolerance, Risk Direction and finally the likelihood of a Fraud.

It is the view of the researcher that if the RCSA is correctly embedded to the critical processes in Branch Operations then it could effectively manage the Branch Frauds. As such a proactive participation of the Operational Risk Units in monitoring, analyzing, studying, assessing the effectiveness of internal controls are essential. This proactive engagement will strengthen the Branch Risk and Controls Self-Assessment process which in turn will real time combat with Branch Operational Frauds by eliminating the Opportunities to commit Frauds.

Apart from the above, study parameter estimate has further eestablished that the Staff Ethical Behavior & EOHR has a significant inverse relationship with the Branch Operational Related

Fraud Management. Therefore, the HR in Banks must actively involve in combatting Branch Operational Related Fraud Management by their efforts of embedding ethical criteria to the Branch Banking. The Human resource efforts to embed ethics must cover all HR functions specifically recruitment and selection, training and development, performance appraisal, pay and reward management and employee relations then it will play an instrumental role in creating an ethical culture and climate in the Branch Banking. HR efforts should not be carried out in isolation that is only in few functions. These efforts needs to be bundle under four dimensions namely acquire (recruitment), develop (Traning & Induction) retain and motivate ethical employees. This process will create Ethical Organization Culture.

With regard to Internal Audit Methodoligies of the Banks this study factor analysis has identified both Risk based and Cycle based Audits are equally strong factors to reduce Frauds. Therefore, practicing either method is acceptable. However, the surprise element of the Audits, Preventive Approch, Issue escalation and Risk assessement aspects should not be compromoised. It is the view of the writer that preventing Frauds is the responsibility of the Business lines as the first line of defense but it does not mean that Internal Auditors are off the book with regard to finding Frauds and preventing same. The Auditors should consider where the Fraud Risk is present within the organization and should respond proactively via Audit Methodologies when auditing the Branch Internal controls. Evaluation, Examination and Assessment in audit planning is crucial as per the auditing experience of the writer.

The strengthen Branch Internal Control environment is definatelly reduce the Branch Operational Related frauds and this fact has been thematically established in the qualitative part of the study which had also been cross established under the Univariate analysis. The Internal controls such as Supervisiory Functions, Delegated Authority Levels and Surprise Verifications by higher authorities should be strengthened during the day-to-day operations to minimize Frauds. On the other hand, t is the view of the writer that wrong tone at the top, collusion, understaffing, traning and experience also weeken the Controls at day today Branch Operations.

IV. CONCLUSION

Under the parameter estimate in this study it has been identified that the Bank Risk and Control Self-Assessment (RCSA) process and the Bank Operational Fraud Management is inversely related by -2.275odds with significance of p.000. At the same time the Operational Risk Management and Bank Operational Fraud Management are also inversely related by -.832 odds with significance of p.034.

Therefore, it is important to strengthen the Branch RCSA process in order to manage the Branch Operational Related Frauds. The Operational Risk Units to gather with the Branch Network Management should focus predictive and proactive risk management techniques with the help of advance technology, along with Effective Corporation among Branch Staff to make the RCSA process effective. As such it is correct to conclude that lack of awareness of RCSA process among Branch Staff may facilitate fraudsters to exploit this lack of awareness for their gains.

Besides, the study had further established that the Staff Ethical Behavior & EOHR and Branch Operational Related Fraud Management is also inversely related by -.599 odds with a significance of p.045. On the other hand, the Efforts made by the Human Resources and Branch Operational Related Fraud Management is inversely related by -1.209 odds with a significance level of p.001. Therefore, the Human Resource Managements in Banks must proactively involve in combatting Branch Operational Related Fraud Management by embedding ethical criteria to the Branch Banking.

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