

# **Influence of Frauds on the Indian Banking Sector: An Indian Perspective**

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**ABSTRACT:** The number of bank frauds in India is important and rising over time and technology. In 2012 the banking sector saw around 84 percent of reported fraud cases in the financial services sector, according to a survey by Ernest & Young. Society expects banks to be accountable, equal, open and effective. Ensuring that they exercise their duties fairly and fraud-free is an important ingredient for public confidence and goodwill. The present study aims to investigate and evaluate the trend in banking fraud and the role it plays in the continuing growth of non-performing assets in India. The study further aims to shed light on the effects on income of the banking sector in India of rising bank frauds. The study concludes that in recent years, the number of frauds plaguing the Indian banking sector has steadily increased and has a major impact on the competitiveness of the Indian financial sector. Strict government intervention and finding new means of preventing and reducing fraud are the only way forward to safety measure the reputation of Indian banks and give the country's banking sector face-to-face.

**KEYWORDS:** Forensic Accounting, Fraud, Banking Sector, Assets, Corporation

## **I. INTRODUCTION**

In recent years, financial fraud has been reported regularly in India. While banking fraud is often viewed in India as a business cost, the frequency, complexity and cost of banking fraud following liberalization have increased considerably, raising regulatory concerns such as the RBI (Reserve Bank of India). In similar scenarios, employees attempt to deliberately re-present false financial figures or try to better portray the organization than the actual state. The second literature and the main answers have shown that opportunity is one of the most important instruments to undertake fraud. In order to control anybody in the organization, rigorous internal controls are carried out. In a certain case, there can be a strong rationalization with your company like a medical emergency, but at the same time it can also be weak rationalization, meaning that only you want the money and you think he won't get caught.

It is the responsibility of auditors to adapt professional skills to cynicism. The auditors will ensure that proven protocols such as an analysis of the situation and the review at all levels above the fraudster in the company are followed. The biggest problem in India is public and private fraud. Many control checks were carried out, restrictions that the auditors had used. Fraud and fraudulent activities require absolute public sector management because if there is a greed, opportunity and pressure on every employee at home, scam could be triggered due to a lack of proper supervision.

Fraud continues to be a major problem in the banking and financial services sector, and the rapid increase in fraudulent activity demonstrates how difficult fraud can be identified and prevented from being manipulated by criminals. The health of a nation's financial and banking system facilitates the determination of its goods and services production and consumption patterns. It serves as a direct measure of people's standard of living and happiness.

Therefore, if the banking structure is hit by increased fraud and therefore increasing NPAs, it becomes a source for concern, since it mirrors borrowers' and clients' financial anguish and transmission mechanism inefficiency. In recent years, banking fraud in India has steadily increased. Although in India, banking fraud has often been treated as a cost of business, its frequency, complexity and cost of fraud has swelled in many ways following liberalization and caused very serious concerns to regulators because of its harsh impact on the banks' profitability and thus on the Indian economy.

The main contributions and organization of this paper are summarized as follows: In section II we describe literature review of Forensic accounting. The section III objectives and hypothesis. The section IV Research methodology. Finally in section IV we concluded the paper.

## **II. LITERATURE REVIEW**

The indications of inadequate internal controls, according to Albrecht (1996), increase the likelihood of fraud. Internal monitoring symptoms include a poor monitoring environment, a lack of segregation of duties, lack of physical safety measure, lack of independent inspections, lack of proper permission, insufficient documents and records, overriding existing inspections, and insufficient accounting systems. Calderon and Green (1994) reviewed 114 actual corporate fraud cases, reported between 1986 and November 1990 in the Internal Auditor. We found that 60% of fraud cases accounted for restricted duty separation, false reporting and insufficient or non-existent control. In addition, the study found that 45% of the cases involved professionals and managers.

Barnes (1995) has stressed that quality training for bankers not just helps develop job-related skills, but also maximizes bankers' performance capacity and offers them a sound knowledge and understanding of banking practices and principles. Education in this regard is of paramount importance. Ganesh and Raghurama (2008) believe that training enhances employees' skills, knowledge and commitment to their work.

Bhasin (2007) investigated the reasons for check frauds, the extent of fraud in Indian banks, and the way in which internal auditors' expertise can be incorporated to detect and prevent bank fraud. He emphasized that although the branch leader is responsible for ensuring compliance with approved systems and procedures, internal auditors at the bank often hold a special role in fraud detection and prevention. Auditors may take several "proactive" steps to contest fraud in addition to taking account of the common types of fraud "signals." Checking fraud calls for preparation, checking of accounts, checking of signatures and sharing information with local authorities and regulators.

R. R. Soni R. And Soni Neena (2013) attempted to investigate both private and public sector banks' cyber fraud. The proposal aimed to incorporate and make meaningful analyzes on the idea of cyber fraud in the banking sector. RBI website data have been used to support the study. The study concluded that the number of cyber frauds among private sector banks and other foreign banks is significantly higher than in public sector banks. It also revealed that although the number of bank cyber frauds decreased considerably, the amount of such frauds did not decline accordingly.

P.K. P.K. Gupta and Sanjeev Gupta (2015) noted that the regulatory system is very weak and that the role of auditors in the globalized business environment today needs to be redefined. The study suggests that fraud could be minimized by diligent and deliberate efforts by auditors and corporate leaders who, given the demands of investment companies, government securities regulators and exogenous market swings, are able to prevent financial fraud. The investigation also attempted to examine the role of fraud perpetrators, the amount of fraud and the modus operandi behind fraud.

## **III. OBJECTIVES AND HYPOTHESIS**

1. To review and analyzed the trend of frauds plaguing the banking sector in India.
2. To examine the impact of frauds in the continuous rise of NPAs in the Indian banking sector.
3. To elucidate the impact of rising bank frauds on profitability of the banking sector in India.

1. Impact of frauds on rising Non-Performing Assets in the Indian banking sector.

Ho: Frauds do not have a significant impact on Non-Performing Assets in the Indian banking sector.

H1: Frauds have a significant impact on Non-Performing Assets in the Indian banking sector

2. Impact of frauds on rising Non-Performing Assets in the Indian banking sector.

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#### **IV. RESEARCH METHODOLOGY**

The present study is based entirely on secondary data. Data from RBI website, annual reports, government reports, academic journals, archived RBI speeches and newspapers were obtained for the purpose of this study. Financial Stability Reports of RBI over the years have also been analyzed to understand the past as well current scenario of the banking sector in India and the various problems that plague this sector. Lack of oversight by concerned officer's w.r.t. deviation management: With existing systems and procedures clearly defined, it is the onus on the senior management to allow specific deviations. Lack of seriousness and knowledge regarding the same may create havoc and lead to a fraud.

i. Failure to control the deviation management of the officer concerned: it is the duty of the management to permit particular deviations where existing processes and procedures are clearly defined. Failure to be careful and to know about the same can lead to havoc and fraud.

ii. Non-compliance with KYC guidelines as recommended by RBI: KYC specifications are jeopardized by rapidly increasing the CASA base of the respective divisions (or any unit). RBI recently fined banks for non-compliance with KYC standards. The concurrent auditor, who visits the branch once a month, points out the KYC rules that the branch does not obey and asks for evidence and clarification. It takes about another month. In this lean period, fraudsters open deposit accounts, cash stolen checks and withdraw the amount.

iii. Increasing business pressures on staff: the margins, profitability and expectations of shareholders are under pressure, management passes on to the central management, which in turn transfers the same to the line employees. Scrupulous methods may be used by staff to achieve their respective objectives.

iv. Lack of tools to identify potential red flags: Some organizations can lack adequate systems to provide the signals needed during a loan that turns wrong or breaches an KYC, although they have the right, agile and trained managers.

v. The symptoms of weak internal control systems increase the likelihood of fraud: the symptoms of internal control include ineffective monitoring, a lack of task separation, lack of physical security, lack of independent controls, a lack of proper paperwork and records, the weakening of existing checks and an insufficient system of accounting.

vi. Technological changes: new technology used by the banks is making them more vulnerable to different risks such as phishing, identity robbery, card skimming, SMS phishing, viruses and Trojans, spyware and adware, social engineering, website cloning and cyber stalking. Banking transactions are now moved to debit/credit cards, electronically available networks such as ATMs, RTGS / NEFT, ECS/NECS, Internet banking and mobile banking. This has given fraudsters a happy hunting ground. In turn, each of the commercial banks promotes all these alternate channels to reduce the pressure on branch banking.

vii. Insider fraud, whether arising from coercion, collusion or otherwise, is increasingly considered to be one of Indian banks' most serious threats to fraud. In fact, it doesn't take elaborate learning to decipher that fraud occurs today isn't an act of a person.

viii. Inexperienced staff: People with little or no experience in loans/advances are posted to sectors that have a high portfolio of advances and are forced to complete the loan proposals.

#### **V. DATA ANALYSIS**

Table 1 outlines the number of frauds as well as their corresponding value over the five year period beginning in 2013-14 up to 2017-18. A classification of credit related frauds is also depicted. It is exceedingly clear that the amount involved in frauds has risen drastically in comparison to the increase in number of frauds. Majority of the frauds plaguing the Indian banking sector tend to stem from granting of credit by banks.

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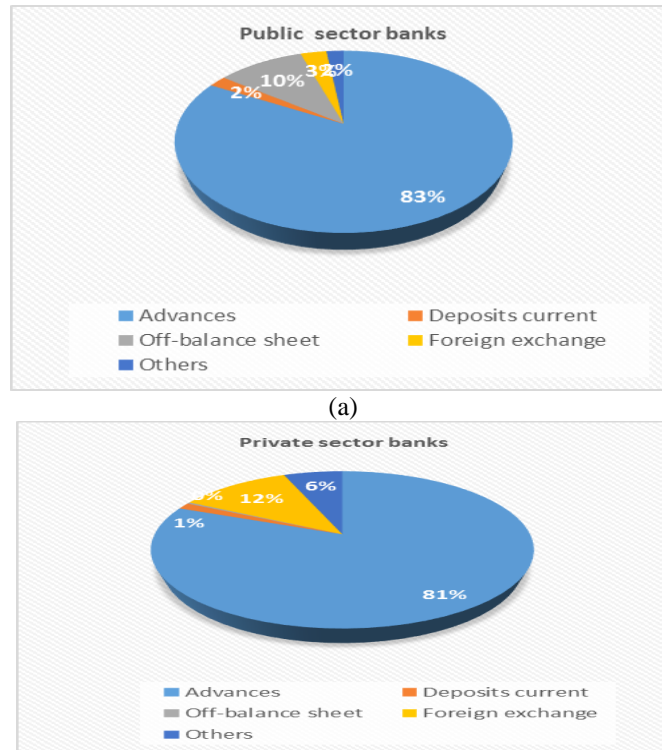


Fig. 1 Frauds from various sources reported in banks  
**Source:** RBI Financial Stability Report 2018

Figure 1 makes an attempt to showcase frauds from various sources as reported by private sector as well as public sector banks. It is very much evident that majority of frauds in the banking sector relate to advances which is a cause of worry for banks in India.

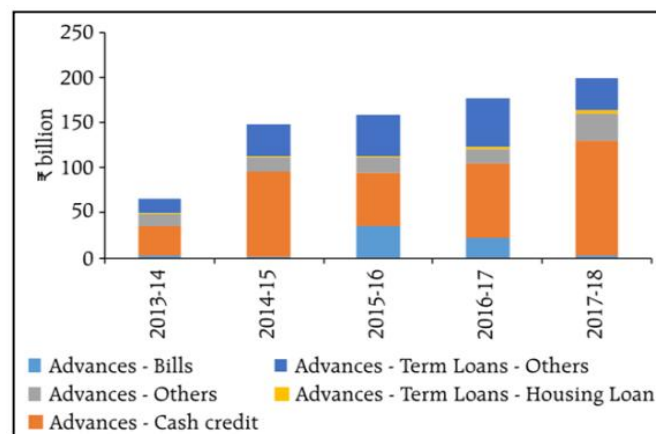


Fig. 2 Advances Related Frauds in Public Sector Banks  
**Source:** RBI Financial Stability Report 2018

Figure 2 further classifies frauds related to advances in Public Sector Banks with respect to bills discounted, cash credit, term loans, housing loans and other advances. It is evident that majority of frauds related to advances in Public Sector Banks arise from cash credit extended by banks to businesses. Table 2 provides a comparative analysis of Gross

NPA and Advances. It is evident that Gross NPAs have risen steadily over the years along with a corresponding growth in deposits. The Gross NPAs to Gross Advances Ratio although not very alarming, has shown a rising trend over the years.

Table. 1 Frauds in Indian Banking Industry

Financial year	Frauds of ₹1 lakh and above (A)				Out of A, Credit related frauds (B)			
	Frauds count	Percentage increment	Amount in billions	Percentage increment	Frauds count	Percentage increment	Amount in billions	Percentage increment
2013-14	4306	-	101.708	-	1990	-	84.121	-
2014-15	4639	1.16	194.551	-3.39	2251	-5.60	171.222	1.44
2015-16	4693	8.16	186.988	28.00	2125	9.27	173.681	18.39
2016-17	5076	16.57	239.339	72.01	2322	8.79	205.614	9.72
2017-18	5917	7.73	411.677	91.28	2526	13.12	225.590	103.54

Table. 2 Gross Non-Performing Assets and Gross Advances

Financial year	Gross NPA (₹ in billions)	Gross Advances (₹ in billions)	Gross NPA to Gross advances Ratio (%)
2013-14	2630.15	68757.429	3.83
2014-15	3229.161	75606.658	4.27
2015-16	6116.074	81711.142	7.48
2016-17	7902.680	84767.053	9.32
2017-18	10361.872	92662.096	11.18

For the purpose of regression analysis, amount involved in frauds is considered as independent variable and Gross NPAs are considered as dependent variable. R Square is 0.8146 which implies that 81.46% variations in Non-Performing Assets are explained by frauds. It is found that frauds have a significant impact on Non-Performing Assets at 5 percent level of significance. Coefficient Value is positive indicating that increase in frauds will lead to a corresponding rise in NPAs. We therefore reject the null hypothesis and conclude that frauds have a significant impact on Non-Performing Assets in the Indian banking sector.

Table. 3 Impact of frauds on rising Non-Performing Assets in the Indian banking sector

**REGRESSION STATISTICS**

<b>R SQUARE</b>	0.81460
<b>COEFFICIENTS</b>	25.4046
<b>P-VALUE</b>	0.03597

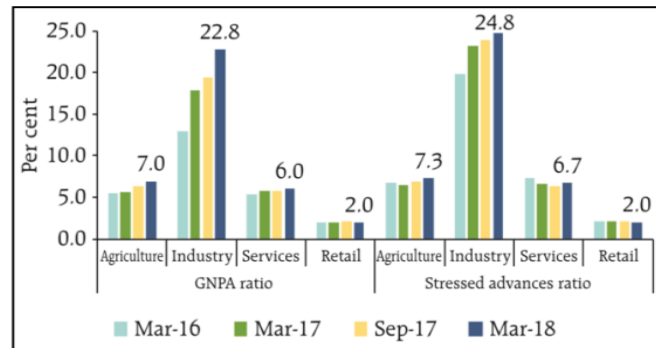


Fig. 3 Asset Quality of Broad sectors  
 Source: RBI Financial Stability Report 2018

Figure 3 depicts the Asset Quality of broad sectors of the economy. Gross NPA Ratio and Stressed Advances Ratio are considered as indicators of asset quality within the banking sector. It is clearly seen that asset quality of industry related advances followed by advances related to the service sector are a matter of concern for the banking sector in India.

Table. 4 Profitability of All Scheduled Banks

Financial year	Net Profit (₹ in billions)
	2013-14
2014-15	890.778
2015-16	341.482
2016-17	438.995
2017-18	-324.377

Source: www.rbi.org.in

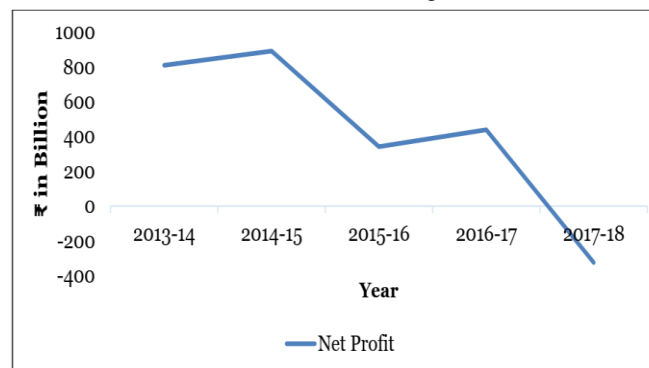


Fig. 4 Profitability of All Scheduled Banks

Table 4 and Figure 4 indicate the trend of profitability in the banking sector in India. It is seen that profitability of banks is on a steady decline which needs to be an eye opener as it poses a threat to the economy.

## VI. CONCLUSIONS

In conclusion, it can be said that though adoption of technology comes with the evolution of time, but protection of public money and people is the greatest challenge responsibility of a modern day banker. Frauds and fraudulent activities wreak severe financial dilemmas on banks and their clients, as well as cause a significant reduction in the quantum of money accessible for economic development. While it may not be probable for banks to conduct their

operations in a zero fraud milieu, proactive measures, such as conduct of risk assessment of policies and procedures can aid banks to circumvent their risk of contingent losses resulting from frauds. The data analysis technology can be leveraged by banks to detect frauds at the incipient stage itself and reduce their loss causing impact significantly. In recent years, instances of banking fraud reported in India are on a steady rise. Even though in India, banking frauds have frequently been treated as one of the costs of transacting business, after liberalization their frequency, complexity and inherent costs of frauds have swelled manifold resulting in a very grave cause of alarm for regulators, due to its harsh impact on the banks profitability and consequently on the Indian economy.

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