

Types of Fraud among Islamic Banks in Malaysia

R. Abdul Rahman and I. S. Khair Anwar

Abstract—The aim of this study is to identify the common types of bank fraud that frequently happen in Islamic banks, the underlying determinants and the amount of losses as a result of fraud cases. The targeted respondents are among managers and officers within Islamic banks in Malaysia. Out of total the 255 questionnaires sent to the respondents, 146 responses were received, giving a response rate of 57.25%. The results indicate that fraudulent statement is the type of fraud that frequently occurred in Islamic banks followed by credit card fraud. Meanwhile, most of the respondents expected the amount of damages due to fraud was more than RM1 million. Furthermore, greed is expected to be the strong determinant of fraud, followed by non-compliance along with insufficient control and financial pressure in the third rank. Insufficient control can be related to the opportunity element in the fraud triangle theory meanwhile financial pressure represents the pressure element of the fraud triangle.

Index Terms—Fraud, Islamic banks, fraudulent statement.

I. INTRODUCTION

Many organisations all over the world are forced to deal with bribery, corruption, and deception in their daily operations. Although banking institution is normally known as one of the most strictly regulated sectors, banks are still a definite target for those fraudsters [1]. The reasons are absolutely obvious; banks are the first option and the best place to come to, due to their role in capital raising and capital intermediation. The consequences of this murkiness is not small, instead may cause banking failure and distress.

According to [2], fraud is an act committed by a party or an individual who uses deception with the intention of getting benefits, avoiding obligation or causing financial or non-financial loss to another party. Although there are many definitions that describe what fraud is all about, the most important aspects of fraud; it happened ‘behind closed doors’ which involve deception and misrepresentation of fact(s) intentionally for personal gain. Indeed, fraud might impose the largest destruction to the whole economic system in general and to the firm structure particularly. Fraud is a risk to business which the impact could be financial loss, reputational erosion, diversion of management energy as well as losing organizational morale. Evidently, fraud is impossible to eliminate, however possible to be diminished by understanding the reasons that cause fraud and take

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proactive actions against it [3], [4].

Due to the lack of scholarly investigation done on fraud crimes in Islamic banks, this paper hopefully fulfils the gap by empirically investigating and ascertaining the types of banking fraud, the amount of losses resulting from fraud, and to gain clear understanding on the determinants of fraud among Islamic Banks in Malaysia.

This paper is further structured as follows. The research method is defined in Section II with results reported in Section III. The conclusions are drawn in Section IV.

II. RESEARCH METHODOLOGY

The sample of the study consists of 17 Islamic banks in Malaysia, as downloaded from the Central Bank (BNM) website at www.bnm.gov.my, as at 30 June 2012. The respondents for this survey were chosen randomly from managerial to official levels in the Internal Audit Department, Risk Management Department and Compliance Department at the headquarters of the banks which are located in the Klang Valley. In fact, the participants in this study are chosen arbitrarily for their unique characteristics or their experiences, attitudes or perceptions and are in the best position to provide the information required.

The study utilizes a questionnaire to assist the collection of information from the targeted respondents similar to that used by [5]-[7]. The questionnaire contains two sections namely respondent’s profile, and understanding of banking fraud. The section on the understanding of banking fraud is to elicit the understanding level of the respondents on banking fraud which can be used as an indicator of the ability to manage fraud efficiently in the future course of action. In addition, this section would test whether the respondents are aware of the current trend of bank fraud as well as the ultimate role to prevent, detect and investigate the fraud cases. The self-administered survey was distributed via drop-off-method (i.e. hand delivery of self-administered questionnaires, followed by personal collection). The actual survey was administrated from mid-August until the end of October 2012. A total of 255 questionnaires was distributed to bankers in local and foreign Islamic banks that operate within Malaysia, however, only 146 were returned which represents a response rate of 57.25%.

III. FINDINGS

Based on Fig. 1, 73% of total respondents were aware that their bank has been a victim of fraud. However, 19% state that they do not know – with the assumption that these respondents have limited knowledge of their bank operation since they were new, at lower position and working at the bank headquarters. The reason is most of the bank fraud cases

normally happen in branches based on remarks made on open ended questions in the questionnaire. Meanwhile, most of the respondents agreed that fraud is actually a common problem towards the banking system. This finding is in agreement with previous survey studies like [8] which discovered the common victimized industry for fraud were the banking/financial services, manufacturing and government/public administration sectors. A study by [9] also figured out banks, credit unions and insurance companies are type of entities most likely to have fraudulent cases.

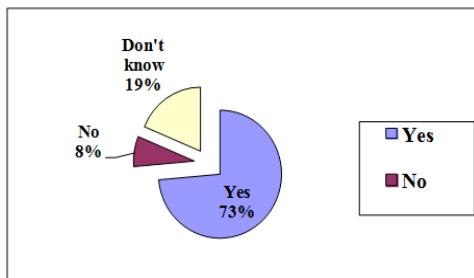


Fig. 1. Response about whether bank has been a victim of fraud.

Fig. 2 discloses 59% of the respondents mentioned their banks have experienced fraud more than ten years. The least respondents claimed that their banks have suffered with fraudulent activities for five to ten years. The rest stated the duration of less than five years for being fraud victims. The result shows that bank fraud exists since a long time ago since most of them claimed for the longest period.

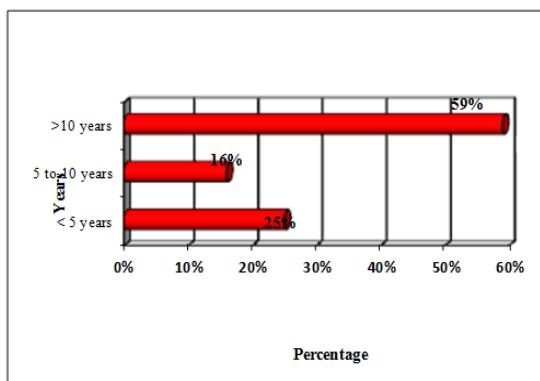


Fig. 2. Number of years bank has been a victim of fraud.

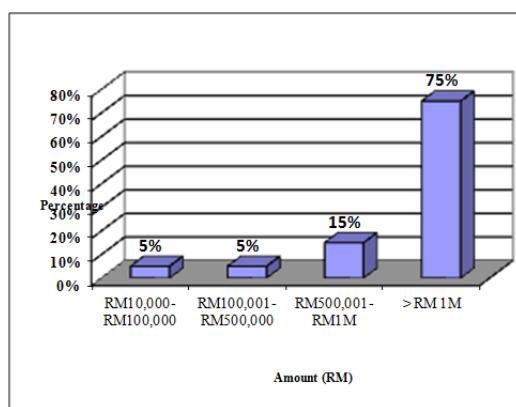


Fig. 3. The amount of fraud losses for the past 10 years.

Fig. 3 highlights that approximately 75% claimed that their bank incurred loss more than RM1 million which can be

considered as a large sum of amount. About 15% out of 96 respondents reported that the losses are between RM500,001 to RM1 million. Such huge amounts are considered realistic since the coverage of fraud was for the last ten years.

Fig. 4 reveals that fraudulent statement occurred most often which accounted for 28 % of the total respondents. Meanwhile, the second highest fraud is credit card fraud (27 %) and computer or internet fraud relates to 16% of the respondents. Only 14% considered asset misappropriation as the common type of fraud inside the banks. This finding is contrary with the report by [8] and [10] which studied the main lines of business industry. Both of the surveys identified asset misappropriation that comprises theft of physical assets and theft of funds as the common form of fraud in the organizations participated.

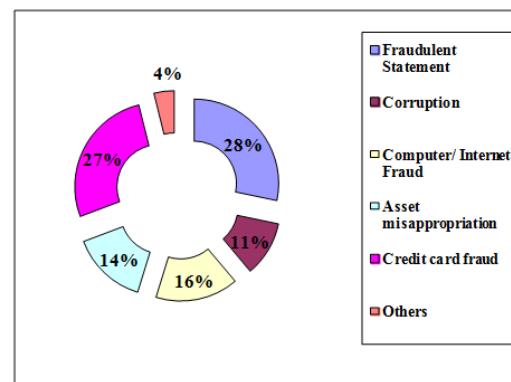


Fig. 4. Type of fraud that bank experienced frequently.

As illustrated in Fig. 5, the leading determinant of fraud is greed (18%). The second highest determinant is non-compliance (17%). Meanwhile 15% of respondents chose insufficient control and financial pressure as the motivation to commit fraud inside the bank. This result is in line with the finding by [10] which indicated greed or lifestyle as the main motivation for fraud to take place. The least chosen determinant is dissatisfaction with the employer.

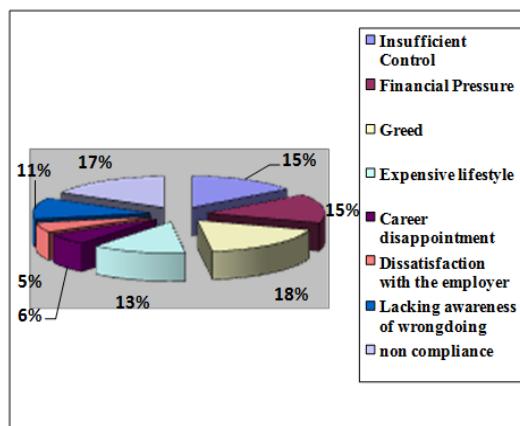


Fig. 5. Determinants of fraud.

As shown in Fig. 6, 37% of the bankers agreed that the credit department is the most vulnerable department for fraud. This department might suffer with variety of fraud, for examples fraudulent statement, identity theft, financial fraud and so on. This is followed by saving or deposit retail (26%) and operation department (25%). The other departments like investment and finance share the same response amount at

four percent each.

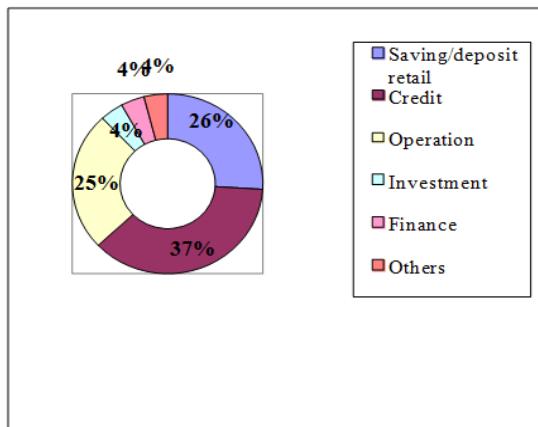


Fig. 6. Department that experienced fraud frequently.

Further analysis shows that the most common perpetrators for bank fraud are the customers, indicated by a 43% response. Both management and non-management employees who represent the internal parties accounted for 22%. The rest consist of suppliers (5%) and others like third party (8%). Based on the result, it can be concluded that external parties expose more harm towards banking system. Moreover, most of the respondents estimate that fraud will occur sometime in their bank which is represented by 42%. Only six percent of the respondents were confident that their bank will not be exposed to fraud threats.

Moreover, 98% of the participants acknowledged that their banks provide fraud awareness training or session to the bank employees. This is considered good because they are conscious that the bank's management is providing an avenue for preventing fraud at the bank. In order to prevent fraud, the ultimate responsibility goes to the management which is agreed by 47% of the respondents. However, some of the respondents also mentioned that the responsibility should go to everyone within the bank and the others said that it is the role of the Board of Director. Meanwhile, for detecting and investigating role, most of the respondents agree that it is under the control of internal auditors (43%) and 21% of the respondents claimed that it is the power of fraud examiners or fraud investigators. Only 5% of the total respondents assigned the job to external auditors.

IV. CONCLUSION

No organization will be immune from fraud regardless whether or not it is an Islamic entity. Fraud will constantly happen no matter how hard we try to deter and curb it. This research will hopefully accomplish the objective of providing information on the Islamic bank fraud which does not differ much from the conventional. Through this research, the bank management and employees will recognize fraud occurred most frequently within the Islamic bank. The most frequent are namely, fraudulent statement followed by credit card fraud. Thus, the bank must be extra conscious and place more concern on these risky components. The amount of losses due to fraud has been estimated more than RM1million for the past ten years. Such big amount stated may provide an 'alarm' to the worst effect of fraud incidents in term of

monetary losses.

The other objective is to determine the motivations of the bank fraud. 28% of the respondents agreed that greed has been the major contribution for fraud to take place. This finding is in line with the previous report by [10]. Thus, the way to encounter this problem is by promoting a culture of compliance and ethical policy. This policy must not be a mere policy on the bank's wall. Only by practicing and installing good ethical behaviour in life, this moral issue can be overcome successfully. Basically, most of the respondents reported the most common perpetrators for bank fraud are the customers themselves. This fact is significantly supported by cases like identity theft in financial fraud, credit card fraud and internet fraud. Therefore, it is the responsibility of the bank to improve their customers' awareness of fraud activities and enhance the bank's security system in order to minimize the cases that involved customers. The fact that the common perpetrators are customers also shows that external fraud has been getting alarmingly serious and may threaten the bank operations as well.

Future research should consider analysing the importance of fraud control techniques that cover certain external fraud. This is because most of the previous literature investigated on internal fraud like fraudulent statement, asset misappropriation and corruption. Thus, the future research should give more emphasis in deterring the external fraud within the organization.

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