

# **Security Managers' Perspectives on Challenges Facing Commercial Banks in Preventing Frauds in Nairobi City County, Kenya**

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## **ABSTRACT**

This paper uses data collected for an MA Thesis on Security Managers' perspectives on challenges facing Commercial Banks in Preventing Frauds in Nairobi County, Kenya. The study was motivated by continued rise of frauds in commercial banks in the county, despite the extensive mitigation measures put in place to deter frauds. The study established the nature of frauds prevalent in Kenya commercial banks in Nairobi County, assessed the determinants of fraud in Kenya commercial banks, determined Bank Security Managers Capacity in fraud prevention, and finally examined Security Managers perceptions on the relationship between the existing preventive measures and emerging Bank fraud trends in Nairobi County, Kenya. The study was grounded by the Fraud Triangle concept and adopted a case study qualitative design. The main method of data collection was the interview. The study comprises of 50 respondents: 39 main respondents and 11 Key Informants. The census sampling Method was used to select respondents for the study. Data was transcribed and the transcriptions coded using NVIVO software. The study established three major types of frauds; Management frauds, Non-Management Frauds and Third Party Frauds, all said to be on an increase trend. According to this study fraud rates are higher at Nairobi County (90%), than at other counties (70%). Mobile and Internet banking frauds were found to be the new threats challenging commercial banks because by their very nature because of technological sophistication, were committed from geographical location including outside the country. The study established two major determinants of frauds; Fraudsters Perspectives and institutional related factors. Major fraudster's perspectives include; condition under which people can rationalize their prospective crimes, opportunities to commit crimes, perceived suitability of targets for fraud, technical ability of the fraudster, the possibility and likelihood of the fraud being discovered and the nature of consequences. Institutional factors that influence fraud prevalence include; weak accounting and control systems, and ineffective internal audits. According to the study, technological sophistication has outsmarted many

**security managers in the banking sector, because of their technological skills gaps in Fraud forensics. Finally, the study established the relationship between existing preventive measures and emerging Bank fraud trends in Nairobi County. Major policy recommendations suggested to cut frauds at the nib include; benchmarking for best internationally recognized standards such as carrying out expected and unexpected audits, enforced internal controls, regular training of security managers, and review of commercial banks organogram that will place security managers at a position to police frauds perpetrated by management.**

**Key Words:** Frauds, Commercial Banks, Security Managers Perspectives.

## INTRODUCTION

Due to Globalization and technological sophistication, almost all nation states of the world are grappling with the problem of Fraud especially in the Banking sector (Zagaris, 2010). Further, this has led to unprecedented high rate of fraud; causing irreparable damage to many other sub-sectors of the economy (Adeyemo, 2012). Apparently, this 21st century technological sophistication has outsmarted many security managers in the banking sector, which is the principal depository of the public's monetary savings, the nerve centre of the payment system, also a conduit through which monetary and credit policies are implemented (Idolor, 2010; Akindele, 2011).

According to Idowu (2009), fraud can be seen as the deliberate falsification, camouflage, or exclusion of the truth for the purpose of dishonesty/stage management to the financial damage of an individual or an organization. It is dishonesty or an act of cheating aimed at causing a person or business to give up possessions or some lawful right. The Association of Certified Fraud Examiners (ACFE, 2008) further defines fraud as the use of one's profession for personal enhancement through the conscious misuse, misapplication or employment of organizational possessions or property. To Siriganga, (2014) fraud is any action by which one person intends to gain a deceitful advantage over another. In other words, fraud is an act of commission which is planned to cause unlawful gain to one person and criminal loss to the other, either by way of concealment of information or otherwise. These include and are not limited to; Voucher Manipulation, Forged or fraudulent documents, Fraudulent loans, Computer Fraud, Letter of Credit Fraud, Money Transfer Fraud, Counterfeit Securities, Account Opening Fraud, Cheque Kitting, Fund Diversion, Forged Cheques, Advance Fee Fraud and other cyber relate crimes.

Arguably, the banking sector has become increasingly dependent on technology though in the absence of a countervailing strategy, for its security management system expected to constantly monitor any suspicious activities on its institutional systems. In all banks, however, this mandate is executed by the security management departments under the superintendence of security managers. This Banking Fraud investigations mandate deals with complex frauds where criminals use high technological sophistication to commit crime which according to this study apparently outsmarts the Banks' security management system, given the increasing rates of fraud cases, a seemingly underlying problem that this study is set to investigate and address.

According to Chartered Institute of Management Accountants (CIMA) report, (2009) banks generate volumes of data on daily basis that greatly impact on the effectiveness of how such information is synthesized and interpreted in terms of fraud and corruption risks. New banking

Fraud investigation technologies are required today to facilitate banking fraud investigators to keep pace with ever increasing data volumes as well as regulatory complexities (Siriganga, 2014). Lack of requisite digital and forensic capacity may make it difficult for investigators to collect and preserve computer generated evidence.

According to ACFE (2008) there has seen a steady shift from traditional show-off hacking towards cybercrime with great economic consequences for society. The different threats against online services are getting worse, and risk management with respect to denial-of-service attacks, phishing, and bank trojans is now part of the agenda of most financial institutions. Fraudsters wield technology like weapons to commit their crimes. Fraud examiners must match and supersede their foes with advanced high-tech tools (ACFE, 2018). Fraudsters are obtaining customer data through hacking, in social engineering attempts, on the dark web and through criminal networks following data breaches, outside of banks control (ACFE, 2018).

Further, fraud in financial institutions is a global problem. For instance, the Association of certified fraud examiners (ACFE, 2008) survey results reported that U.S banks lost an estimated 7% of their annual revenues to fraud in 1990s (ACFE, 2008). This percentage is higher compare to the estimated 5% for 2006 and 6% for 2004 (ACFE, 2006). In Britain's National West Minister and the Bank of Credit Commerce International (BCCI) lost 10 billion dollars to fraud globally and Japans Fuji Bank lost 3 billion dollars to forgery both in 1990 (ACFE, 2018). In fact, the fraud bubble burst in Japan's financial sector in the early 1990s lost huge sum of money due to unrealistic valuation of land, share price manipulation, poaching of staff, financial engineering, huge uncollected bad loans and issuance of fake certificates (Anca, 2013).

The KPMG (2011) report on the African Fraud survey indicates that fraud is a major concern among African banks. Six percent of the African Fraud survey respondents said they had lost 170,000 dollars or more to fraud in the year 2007 (KPMG, 2011). Furthermore, the economic survey of 2010 by PWC registered an increase of fraud incidents and cases in the year 2010 than in any other preceding years. This growth in the banking frauds was grounded on the rapid growth and expansion in banks which necessitated the implementation of complex multiple technological systems that promoted high levels of fraud (Price Waterhouse Coopers (PwC), 2011). In Ghana, a study done by Atta (2020), revealed that, money laundering, forgeries and falsification of documents were the major avenues employed in defrauding universal banks. Similar observations were earlier made in Nigeria, Zimbabwe, Tanzania, Zambia, Rwanda and Uganda. (Onodi, Okafor & Onyali, 2015).

In Kenya, despite the highly regulated banking industry, frauds continue to thrive (ACFE, 2010). As a result, the Banking Fraud Investigations Unit data (BFIU), indicates that banking sectors reported loss of Ksh1.49 billion from customers' savings alone between April 2012 and April 2013. However, Fraud detectives from Banking fraud recovered Ksh530 million from Kenyan bank sectors in 2014, in the arrangements devised by bank staffs (BFID, 2014). Frauds in the banking industry have gotten to a level at which many stakeholders are losing their trust and confidence in the industry. Central Bank of Kenya (CBK, 2013) fraud data indicates incidences of banking fraud have increased by between 3-5% of entire financial transactions, from as low as 0.5%, in the previous five years (CBK,2013). Other statistics from Central Bank of Kenya's supervision report, 2013, indicates that commercial banks make an average loss of Kenya

shillings 100 million to fraudulent activities monthly (Gaitho, 2013). It is upon this background that this study is set to find out to investigate the causal factors and inform policy formulation and recommendations with regard to cushioning commercial banks against fraud in Nairobi County, Kenya.

### STATEMENT OF THE PROBLEM

The Kenya Banking Fraud Department Annual reports still indicate the continued rise of fraud cases that has costed the banking industry about five percent loss of its annual revenues. This is despite government's efforts through the CBK and other auxiliary bodies such as KBA, KBSS and the BFID to cut the problem at the nib. However, Banking Fraud persists in Kenya, and now with increasing perceptions that it is on the increase than decrease trend. Several previous studies that have been done in this area mainly focused on general fraud preventive measures, albeit in the broader context of financial institutions. This current study narrowed down and focused on frauds in commercial banks only. Further, the study dug deeper and assessed the problem from the perspective of the people charged with security oversight in the commercial Banks themselves. Besides, this perspective has never been subjective of systematic investigations and analysis, hence the rationale for this study.

### METHODOLOGY

A case study research design was used for this study. This design is qualitative in nature and presented more enhanced insights into the research problem and additionally provided flexibility for the researcher to highlight pertinent issues with precision. The target population for this study were security managers of all the 39 commercial banks in Nairobi County, Kenya. This study utilized a census sample strategy because the target population was manageable and the respondents easily accessed (Kothari, 2014). As is always the case with all census inquiries, all the respondents were enlisted, and enumerated. The collected data was transcribed, and the transcriptions coded using NVIVO software, computer software for managing qualitative and quantitative data.

### RESULTS AND DISCUSSION

The researcher reached 38 out of the 39 targeted respondents as depicted in Table 1. This was attributed to the fact that the officer who didn't take part in the study was out of Nairobi on official duties. The respondents comprised of security managers of commercial banks. The respondents reached a response rate of 97.4 % of the expected sample. According to Mugenda and Mugenda (2003) the response rate of more than 70% is very good, 60% response rate is considered good while 50% of the response is considered adequate for analysis. Based on this recommendation the response rate of 97.4% was considered and exceptional for this research.

**Table 1: Response rate**

|              | <b>Frequency</b> | <b>Percent</b> |
|--------------|------------------|----------------|
| Responded    | 38               | 97.4           |
| No response  | 1                | 2.6            |
| <b>Total</b> | <b>39</b>        | <b>100</b>     |

**Source: Author, 2022**

## Demographic Information

This section presents the demographic information of the respondents namely; the gender, age and level of education of the respondents. The results are presented below:

### Gender of the Respondents

The study also sought to establish the gender of the respondents. The findings are presented in the Table 2.

**Table 2: Gender of Respondents**

| Gender of Respondents | No of Respondents | Percentage (%) |
|-----------------------|-------------------|----------------|
| Male                  | 37                | 97.4           |
| Female                | 1                 | 2.6            |
| <b>Total</b>          | <b>38</b>         | <b>100</b>     |

**Source: Author, 2022**

Table 2 shows that majority of the respondents (97.4%) were male while minority of the respondents were female (2.6%). The fact that majority of the respondents were male, may have been attributed to the fact that most bank managers are retired officers of the disciplined forces, a profession in most cultures particularly in Africa that is male dominated. This lends support to findings by Oruta, Lidava and Gaunya (2016) who had a similar observation arguing that "women are still underutilized by law enforcement agencies.

### Level of Education

Further, the study sought to determine the highest level of education attained by the respondents. The findings are presented on Table 3 below.

**Table 3: Level of Education**

| Level of Education | No of Respondents | Percentage (%) |
|--------------------|-------------------|----------------|
| Diploma            | 4                 | 10.5           |
| Graduate           | 30                | 79.0           |
| Post graduate      | 4                 | 10.5           |
| <b>Total</b>       | <b>38</b>         | <b>100</b>     |

**Source: Author, 2022**

Table 3 indicates that majority of the respondents were graduates (79.0%) diploma holders (10.5%) and post graduate degree holders. The findings imply that the respondents understood the questions being asked and offered the much needed necessary information to answer all the research questions. Moreover, the level of education also indicates respondents were literate to take part in the study.

### Respondents Length of Service

On average, the officers that participated in this survey were fairly experienced having served in the banks security service for 11 years. Some of them had served for five years while others had served for two decades as shown in Table 4. This is an indication that all respondents had the much needed experience that enriched this study.

**Table 4 Respondents Length of Service****Descriptive statistics**

|                                             | N        | Minimum | Maximum | Mean  | Standard Deviation |
|---------------------------------------------|----------|---------|---------|-------|--------------------|
| Years of Service in Bank Security Valid (N) | 38<br>38 | 5       | 20      | 11.16 | 7.591              |

**Source: Author, 2022****The Nature of Frauds prevalent in Kenya Commercial Banks in Nairobi County, Kenya**

The first objective sought to establish the nature of frauds and their prevalence in Kenya commercial banks in Nairobi County, Kenya.

***Nature of Frauds in Kenya Commercial Banks in Nairobi County, Kenya***

The first objective established three major types of frauds; Management frauds, Non-Management Frauds and Third Party Frauds. Nature of management frauds committed in Kenya commercial banks include generating fictitious revenues, improper asset valuation, concealed liabilities and expenses, overstated assets, and understated liabilities.

Major Non-Management Frauds committed in commercial banks in Nairobi County, included; Illegal transfer of funds, Mobile and Internet banking fraud, Opening and operating fictitious accounts, Withdrawing monies from the customer account, Forgeries of customer's signatures, Staff thefts/misappropriation, Creation of fake vendor accounts, and Claiming of overtime for hours not worked.

Major third party frauds in Kenya commercial banks include Card Frauds, Account takeover of deceased/diaspora/dormant high-value accounts, Counterfeit Securities, Social engineering and Cheque Frauds. Other third party frauds include; ATM jackpotting, thieves following Clients who withdraw cash at the branch, Credit card fraud, Money laundering, Internet fraud, Phishing, Pyramid schemes, Drugging merry-making customers and emptying their accounts-Scopolamine drug/Devil's breath/mchele, and Hacking of Bank Systems/ pay bills. The general trend in this study however is increasing rate of third party frauds in Kenya commercial banks.

***Prevalence of Frauds in the Banking Industry***

This study's finding indicate that country wide fraud trends are generally lower than Nairobi county fraud trends. Additionally, although third party frauds remain high at both national (70%) and at Nairobi County levels (90%), the trends are comparatively higher in Nairobi than outside Nairobi. The fact that commercial bank fraud trends are higher at the Nairobi County than at National levels may be explained by the fact that, given the current highest trends according to this study are Mobile and Internet banking frauds, the level of technological sophistication is higher in Nairobi than in the country side. Nairobi County is also likely to have more wealthy investors than in the country side.

## **Determinants of Frauds in Kenya commercial Banks in Nairobi County, Kenya**

This study sought to establish the determinants of Frauds in Kenya commercial Banks in Nairobi County, Kenya. The two major variables that were examined include; Fraudsters Perspectives and the effect of institutional factors on fraud prevalence in the Nairobi, County. The results are explained below.

### ***Fraudsters Perspectives***

According to 90 percent of the respondents, major fraudster's perspectives include; condition under which people can rationalize their prospective crimes away, opportunities to commit crimes, perceived suitability of targets for fraud, technical ability of the fraudster, the possibility and likelihood of fraud discovery, expectations and consequences if they are caught. In explaining these variables, the key informants were the strongest voice. For example a respondents stated,

*"Fraudsters commit crimes because there are motivations that pressure them such as financial needs and greed for material things. Further, they commit crimes because there are ignorant victims who are not target hardened. Beside, some fraudsters are so educated and technologically empowered sometimes a head of security personnel. Such sophistication makes possibility for their discovery very slim. They are so daring especially in a situation where the benefit of their actions outweighs the consequences of being caught"*

The above findings lends support to finding by CIMA (2009) and Central Bank of Kenya Supervision Report (2017) that Fraud cannot be studied, examined or attributed to one factor only. On the contrary, a multifaceted and multifactor approach to the study of fraud must be undertaken. Looking at a fraudsters perspectives, is necessary to take account of motivation of potential offenders, condition under which people can rationalize their prospective crimes away, opportunities to commit crimes, perceived suitability of targets for fraud, technical ability of the fraudster, the possibility and likelihood of fraud discovery and carrying out, expectations and consequences, in order to inform policy recommendations if the problem of fraud is to be cut at the nib.

### ***Institutional Perspectives on Fraud Prevalence in the Nairobi, County***

According to 88 % of the respondents, a number of institutional factors that influence fraud prevalence include; weak accounting and control systems, ineffective internal audit, inadequate supervision of subordinates, poor information technology and database management, poor salaries, Banks reluctant to report fraud due to the perceived negative publicity, inadequate training and hapless human Resource. As a key informant stated,

*Other additional factors include inexperience of staff and inadequate infrastructure that may include poor communication systems that result to a buildup of unbalanced posting, inadequate training, poor book keeping and economic hardships. Further, Rationalization of the fraud act, poor internal controls, lack of implementation of laws and policies and managements indifference to the acts of fraud are major drivers of employee theft. Further, regarding opportunity, the first important factor motivating fraud. Opportunities to commit fraud represent gaps, deficiencies, weaknesses and loopholes in the internal control systems of a business that an employee can utilize to commit fraud.*

*Besides, Complexity in bank systems can be seen in the growing number of channels through which banks now deliver their services including websites and online banking platforms, mobile apps and social networks. All these channels represent a new set of opportunities for fraudsters to gain access to the bank's information system. Additionally, Banks' working system has become more complex as new information systems are implemented on top of older systems, building up layers of technology that do not necessarily link together and so make it much more difficult to gain a unified view of operations. As mainframes have given way to network computing, critical systems have also become more distributed today even a relatively small institution will have multiple databases running on different servers that are accessible to many staff. Complex and highly distributed IT systems are difficult to police and present more opportunities for fraudsters to gain entry.*

With regard to motivations, another respondent stated;

*Regarding rationalizations, Rationalization of the act of fraud also known as the moral justification through which employees create an attitude or thought that committing fraud is proper and right. It is created when an employee justifies his actions or crime through statements such as: it will be impossible for the company to find, the company can do without it, I am not stealing, the company does not recognize my efforts and therefore it's my reward for hard work. This justification for the act of fraud often leads to fraud in the business.*

The above findings lend support by Wang and Kleiner, (2005) that all said and done the back stops at the management for their inaction against fraud also deemed as a major driver of fraud in the organization (Wang & Kleiner, 2005).

### **Influence of Bank Security Managers Capacity on Fraud Prevention**

The third objective sought to establish the Influence of Bank Security Managers' Capacity on Fraud Prevention. The study sought to establish the effect of technological skills gap and training in Forensics on fraud prevalence. Both interviewees and the Key informants had the strongest voice in this. For example, there was an overwhelming view from 97% of the respondents that the 21st century technological sophistication has outsmarted many security managers in the banking sector, because of their technological skills gaps in Fraud forensics. This has been brought about by gaps in training and retraining that were deemed necessary if banks are to cut this problem at the nib.

For example, an interviewee stated,

*"Banking Fraud investigations deals with complex frauds where criminals use high technological skills to commit crime. Lack of adequate training and retraining of human resources both on the practical and theoretical aspects of banking activities and operations often leads to poor performance. This inefficient performance creates a loophole which is being exploited by fraudsters. Training employees is critical to enhancing financial institutions' capacity to detect and respond to financial exploitation and also to prevent fraud.*

The above finding lends support to findings by Qonde and Chepkonga, (2017) that fraud perpetrators may be more conversant with digital aspect of technology hence investigators

require a range of skills coupled with the experience to apply those skills in real and virtual environments.

### **Security Managers Perceptions on the Relationship between the Existing Preventive Measures and Emerging Bank Fraud Trends in Nairobi County, Kenya**

The fourth objective sought to establish Security Managers perceptions on the relationship between the existing preventive measures and emerging Bank fraud trends in Nairobi County, Kenya.

#### ***Encouraging Work Atmosphere***

According to 98 percent of the respondents there is a good working culture in almost all Kenya commercial Banks in Nairobi County, Kenya. This includes having adequate and sufficient policies, rules, regulations, procedures, protocols and practices human resource management of employees (recruitment, selection, orientation, development, remuneration, career advancement, motivation, and termination). According to this study however 83% of the respondents indicated that two critical components of human resource management of commercial bank employees is still inadequate; i.e. trainings and provision to protect whistle blowers. This remains a grey area, in these financial institutions and is also inconsistent with requirements of international standards to deter fraudulent and corrupt behaviors; practices that deal swiftly with incidents and protect whistle blowers (Adeyemo, 2012).

#### ***Ethical Culture***

According to 78% of the respondents, an ethical culture that includes defining principles and values with indicators of high levels of ethics in the organization as well as zero tolerance to corruption and fraud is lacking in commercial Banks in Nairobi County. Management fraud was also reported among Kenya commercial banks Management staff. This is inconsistent with internationally recognized standards that require ethical culture to be incorporated via ethical leadership as a model of appropriate conduct in the face factors and behaviors that would promote or motivate employees to engage in fraud (Adeyemo, 2012).

#### ***Perform Expected and Unexpected Audit***

According 98% of the respondents, commercial Banks in Nairobi County, Kenya conducts both Expected and Unexpected Audit albeit not thorough. According to the study such exercises should be regular and thorough. The implication is that this may be a possible gap that has exposed banks to fraudulent activities and as such explains why fraud cases are on the rise. This finding is also inconsistent with international norms and rules of commercial banks procedure that requires regular and unannounced financial audits and fraud assessments to deter potential employee frauds (Adeyemo, 2012).

#### ***Enforce Internal Controls***

According 94% of the respondents, commercial Banks in Nairobi County, Kenya, they have internal controls albeit weak. Whereas internal controls are designed to promote operational efficiency, provide dependable financial statistics, protect the assets and records and encourage adherence to prescribed policies. According to this study, sound internal controls are lacking in commercial Banks in Nairobi, Kenya. Ideally, a sound internal control system has features that promote efficiency and effective tracking of transactions and ensuring that all activities are properly authorized, recorded, and reconciled and should have all principles and procedures

that support the organizations effective and effective operations. The implication is a vulnerable financial system open to frauds and insecurity. This finding is again inconsistent with required security specifications that require all banking institutions to prioritize such control to deter frauds (Adeyemo, 2012; CIMA, 2009).

### ***Establish a Fraud Policy***

Whereas 43 % of the respondents agree that there are anti-fraud policies in Kenya commercial banks on the Nairobi County, there was consensus in all that the policies are not weak. The possible explanation could be because a pocket of management staff are also implicated in it and that good will to combat frauds could also be lacking. Ideally, every bank should have an approach to deal with fraud. The approach should be clearly stated in the fraud policy and established to facilitate the implementation and actualization of internal fraud controls. This may include; orientation of new hires, annual training seminars and annual performance evaluations. This finding lends support to recommendations by Hillison, Pacini & Sinason, (1999) that such policies should be signed by each employee when being hired but again according to this study enforced by security managers.

### **CONCLUSIONS AND RECOMMENDATIONS.**

Frauds, whether; Management frauds, Non-management frauds or Third party frauds are on an increase trend. Internationally recognized standards require ethical culture to be incorporated via ethical leadership as a model of appropriate conduct in the face factors and behaviors that would promote or motivate employees to engage in fraud. Because of frauds by management staff, security managers may not police frauds committed by their bosses. In order to address the puzzle, there is urgent need for revision of commercial banks organogram and place security managers at par with managers perpetrating frauds, if the management frauds are to be cut at the nib.

The study identified two major determinants of frauds; Fraudsters perspectives and institutional perspectives on fraud prevalence. To discourage fraudster's perspectives the study recommends harsh penalties to discourage frauds. To tame the institutional factors the study recommends; enhancement of accounting and control systems, in addition to internal audits. Further, the study recommends putting in place practices that deal swiftly with incidents and protect whistle blowers (Adeyemo, 2012; CIMA, 2009).

The study established the Influence of Bank Security Managers' Capacity on Fraud Prevention. According to the study technological sophistication has outsmarted many security managers in the banking sector, because of their technological skills gaps in Fraud forensics. This has been brought about by gaps in training and retraining that were deemed necessary if banks are to cut this problem at the nib.

Lastly the study established a relationship between the existing preventive measures and emerging Bank fraud trends in Nairobi County, Kenya. The study recommends enhancement of several preventive measures that were assessed in line with the internationally recognized standards. These include; creating an encouraging work atmosphere, ethical culture, carrying out expected and unexpected audits, enforced internal controls and enforcement of commercial banks anti-fraud policy.

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