

Case Study – “XYZ” Bank

Background

“XYZ” Bank is a major European bank. As with other major banks, it needed to be represented in the major financial markets and hence had established a branch in Hong Kong.

The activities of the Hong Kong branch were split between a trading operation and corporate banking. Its trading arm was active in the foreign exchange and bond markets. Its corporate banking arm lent the bank’s funds to various commercial institutions.

The Hong Kong branch had only been set up a few years ago and in many ways was an experiment. When it was set up, it had been forced to adopt the same back office system as the branch network in the bank’s home country. This had caused obvious problems.

The branch’s computer system was not made for a one-off operation like Hong Kong but was designed for a retail bank network. Hong Kong’s requirements were very different. For example, it had to be able to cope with a front office that was actively trading and offering a portfolio of derivative products to the market.

The result was that at the end of every day, certain trades had to be input manually into the bank’s system. Due to their complex nature, these adjustments were made on the sole instruction of the Head of Operations and carried out by a team of local staff with little settlement experience. Nobody checked the work of the Head of Operations or even understood the manual system that he used. The Head of Operations had not taken a holiday in a long time. I

The bank had no internal audit function in Hong Kong, but instead relied on a visit from the Head Office internal auditors every two years. When they did come, the first thing they would do was to count the petty cash. They would then spend up to two months at the branch looking at a range of areas (particularly administrative matters). The internal auditors usually coincided their visit with the Chinese New Year holiday period and brought their families over with them to go shopping in Hong Kong. They would generally stay for the Hong Kong Rugby 7s in March, when the Head of Operations would arrange corporate entertainment for them through his contacts.

A local Financial Controller had been employed by the Head of Operations and he was also responsible for compliance and money laundering matters. The Financial Controller was a very capable man but was far too busy keeping the back office together to provide an effective compliance function.

The Branch Manager was an ex-military man, and kept himself to himself. His office door was permanently shut and he was not approachable. There was a management committee (consisting of all the senior managers at the branch) but its meetings were infrequent and no minutes were kept of what was discussed. The Branch Manager was the only real line of communication to the Head Office.

Business had been good on the trading side during the year. Despite losses in the first few months of the year, the overall profit figure was now looking very healthy. A dispute, however, had arisen between the front and back office as to how much money the bank had actually made. The front office believed they had made HK\$20 million more profit than the bank's system was reporting. This dispute had been running for months and showed no sign of being resolved.

Business on the corporate banking side, however, had not been so good. The corporate banking market had been difficult during the year and the market niche where XYZ Bank operated was especially tight. Despite the arrival of this new high-flying Head of Corporate Banking, unusually high numbers of new loans had defaulted almost immediately after inception. There had also been two key resignations in the corporate banking department.

Nobody knew that much about the new Head of Corporate Banking. His CV looked impressive and all the references that he gave had been taken up successfully (as they would be with any member of staff). He did however have a set way of doing things. He liked to use agents to arrange loans and was keen to lend money to companies where he had good connections with the directors.

Certain irregularities had occurred over the year. Some of the back office staff had noticed that unusual packages were appearing in the Bank's safe. These were apparently being kept for clients on a temporary basis. A large sum of money had also been transferred to a Swiss bank account under suspicious circumstances.

Towards the end of the financial year a writ had been served against the Bank, alleging that the Bank had given a negligent reference on behalf of one of their corporate banking clients that had resulted in the plaintiff suffering financial loss.

Visit of the Forensic Team

The Bank's European Head Office called its auditors, who referred the matter to their Hong Kong Forensic & Investigative Services team.

Two Forensic Accountants were subsequently instructed to go and visit the Hong Kong branch. For both of them it was their first time at the Bank and they did not know what to expect.

The visit started well and the initial conversations with the Branch Manager raised few issues. However, as the day progressed the Forensic Accountants sensed that something was not quite right at the Bank.....

Required:

1. Attendees are asked to consider the fraud/corruption risks inherent in the given scenario.
2. Attendees are invited to guess what fraud/corruption has occurred.