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Part 1

i. CBA Scandal Discussion

In recent year, it has becoming increasingly common for company to be involve in scandals surrounding the financial and banking sector in relation to unethical behaviour, misconduct and the associated corporate culture. It can be argued that it is possible that those company has been practicing those questionable tactic for years, but due to recent increase in scrutiny toward which reveal the flaws that these company are trying to hide. Banking Royal Commission was recently established inquire into these numerous scandals especially scandal that concern the big 4 banks of Australia despite strong opposition by the government initially. The Banking Royal Commission investigates misconduct in the financial service sector which involve banks giving out questionable financial advice, misuse of customer retirement savings and other behaviour that is deem “below community standards and expectations”. It was established on 14 December 2017 and is currently still active.

It is also important to look at what lead to the establishment of Banking Royal Commission. It could be argued that an expose of a sales-driven culture within the CBA financial planning division is where the idea of establishing of Banking Royal Commission start its conception. (Banking Bad, 2014) Therefore, in this discussion, CBA will be chosen as the main focal point to represent the financial and banking sector regarding the scandals given their size and influence on the Australian economy. CBA is involved in many scandals since then, but this discussion will be looking mainly into 3 area which include Consumer Lending, Financial Advice and Superannuation.

Consumer Lending is one of the area that the Banking Royal Commission inquire into and they found that CBA activities in this area are rather questionable. CBA is currently under scrutiny over their failure to assess ability of their customer in repaying their debt prior to granting a credit card limit increase. There has been reported case that CBA offer a credit card limit increase to an addicted gambler which can only be describe as a despicable exploitation of their customers. (Hutchens, 2018) This is a direct contribution or outcome of their sales-driven culture which prioritise profit rather than moral or sustainability. In addition, CBA was also responsible for selling credit card payment protection policies to people who can't claim on the product. (Danckert, 2018) Moreover, CBA has also fail to disclose the value of commissions it pays to mortgage brokers in return for selling its

product a. This give the mortgage broker the incentive to encourage customer to take out larger homes loan and for longer term than they needed. Building on top of the sales-driven culture at CBA, it has also been reported that Broker who fail to write sufficient loan for them are being de-accredited. (Janda, 2018)

Another area that involved in the scandal is Financial Advice. This scandal involves the bank charging a fee to customer while providing no service back. This was apparent when CBA planner was charging clients fee long after they died, in some cases over a decade. (Danckert, 2018) It should be noted that other banks also face backlash for similar scandals however to date CBA is currently paying back \$119 million compensation to its customer which is relatively a lot higher than other institution making CBA “the gold medallist of fees for no service”. (Hewett, 2018) Additionally, regarding this scandal, CBA’s executive director Marianne Perkovic was also accused of providing misleading evidence in which she claims that the bank was still determining whether this issue was serious enough to report to ASIC. These collective scandals result in CBA selling its wealth business which include its planning arms

Furthermore, Superannuation related issue was also a focus of the Banking Royal Commission regarding the scandal surrounding the banking and financial sector. According to the hearing, CBA along with other banks was found to put their interest over the interest of their superannuation members. CBA is found to have failed to move 15,000 superfunds to the MySuper accounts by the deadline which show their lack of responsibility for their clients. (Special Broadcasting Service, 2018) This was made worse when the number was initially believing to be 13,000, but the actual number was 15,000. Furthermore, instead of correcting their mistake of not moving the superfunds into MySuper account, they employ misleading tactic or rather launched a campaign against MySuper by encouraging customers and financial adviser to make an investment decision. The process of moving superannuation funds should have been an automatic process, but CBA mislead their customer believe that a decision has to be made in regard to their investment decision which discourage many user from using MySuper. It should be noted that MySuper is a low cost, commission-free super accounts that was introduced during the Gillard government which mean it’s less profitable for CBA if all the superannuation is moved into MySuper making their tactic appear to be profit-driven. (ASIC, 2018) This tactic is unethical in the way that it misleads ill-informed customer who doesn’t have proper financial knowledge.

The inquiry by the Royal Banking Commission has certainly reveal truly unethical behaviour, misconduct in the banking and financial sector. It is unacceptable that a sector that has this much influence on the economy can operate this way. However, it is important that one could identify what is the cause of the problem and not just identifying the problem without a proper explanation for it. It can be argued that these unethical behaviour and misconduct tend to be a result of defective corporate culture which usually relies on pressure which in turn force employee to be unethical leading to spread throughout the company. This highlight the importance of a good corporate culture, but this lead to another question which one is how can quantify or identify a good corporate culture which lead to the conception of various model notably the Schein's model. Schein's model relies on 6 mechanism which include Attention, Reaction to crisis, resource allocation, role modelling, rewards and selection & dismissal. (Dellaportas, Thomsen and Conyon, 2012) In contrast, one could also use this model to explain the defective corporate culture of CBA.

To determine how bad the associated corporate culture is at CBA, one could look at the first mechanism of Schein's Model which is attention or rather what tone is being set at CBA. According to the information above, CBA place priority on profit above all else. It's apparent that CBA tend to favour those who bring in the number regardless of the mean of getting those number over those individuals who fail to bring in the number. This is quite clear from their consumer lending scandal with failure to assess credit card limit increase and questionable incentive for mortgage broker. Another mechanism that can be used to explain these behaviour is reaction to crisis or rather 'coming clean' about a certain crisis. This is another failure for CBA according to their scandal surrounding their superannuation scandal where they tried to cover up their failure to move their customer into MySuper by misleading their customer into believing that they are required to invest which grant CBA higher commission. CBA only admit to the mistake when they were back into a corner and must admit to their mistakes while still denying their financial motive.

As for resource allocation, it is difficult to determine if CBA resource allocation could rectify the defective corporate culture given CBA priority in the 2 mechanisms above. This mechanism is possibly an ineffective way to explain the defective corporate culture as company who have defective corporate culture tend to have resource allocated into ethical education and such, but its effectiveness is questionable. Furthermore, the next mechanism which is role modelling is also highlight CBA defective corporate culture. The best example

that could highlight this failure is the promotion of a known unethical employee into higher senior position. According Jeff Morris, CBA whistle blower, Don Nguyen, a financial planner was suspended, but later promoted into senior role to cover up the financial planning division scandal. (Eyers, 2014)

The next mechanism, allocation of reward is also part of the corporate culture failure. As mention above, Mortgage broker who fail to deliver their sale target are de-accredited which is effectively a punishment. It can be argue that it is possible that those mortgage brokers are being de-accredited due to their incompetency however based on the tactic that incentivise mortgage broker to encourage consumer to enter into larger home loan than they needed, it is fair to assume that those who refuse to use this tactic is falling behind other unethical mortgage broker which explain them being de-accredited. Finally, as for criteria for selection and dismissal, this could be link back to role modelling which see a known unethical employee being promoted to cover up their mistake while employee who opposed it is being silenced.

ii. CBA's decision making

It is important that one could identify the motive behind the unethical behaviour and misconduct that's happening at CBA. It is easy to just point fingers to the fact that financial gain is main motivation behind all these unethical behaviour, but this is too broad of a category. This discussion aims to explore theories that could be used to explain this type of behaviour from CBA. To understand what drive the decision-making at CBA, Kohlberg's theory of cognitive moral reasoning & development (CMD) will be use as theory concerning the investigation of reason for a decision rather than the study of the decision itself. In other word, the theory aims to explain why an unethical or ethical decision is made rather than determining whether the decision is ethical or not. Kohlberg theorise that there are 3 level of moral development which is pre-conventional, conventional and post conventional. (Kohlberg, 1973) Each stage involves one considering whether the decision is right or moral. It should be noted that Kohlberg's theory mainly of normative theory of ethics. In pre-conventional level (Level 1) consist of two stages, the moral reasoning is focus solely on one self. The decision is generally made in term of good or bad consequence to oneself. In the case of CBA, it can be argued that the unethical behaviour and misconduct is the result of employee fearing bad consequences having to them. Given the sales-driven culture of CBA, unable is to meet the target is a bad consequence which explain their desire to avoid punishment. As for stage 2, unethical decision behaviour at CBA could be explained by the motivation to pursue self-interest as the benefit of a sales driven culture is a higher commission. The next level is conventional level which consist also of two stages. In stage 3, unethical decision could be explained by the culture of conforming. It stems from the fear of disapproval from peers and not wanting to be left out of the group. In stage 4, the decision usually stems from the justification of oneself that what they are doing is completely legal albeit questionable. Finally, the next level is post conventional level. It has been suggested that people rarely develop into this level with number as low as 20%. In stage 5, this is where decision that are generally deem unethical can't simply be arrive at. Similarly, in stage 6, unethical decision making will simply not make it past. CBA whistle blower, Jeff Morris could be those individuals who develop into the conventional level in which he based his decision on what is just without influence from authority, rules, consequences or the group. Unfortunately, his decision has landed him in an unfavourable position for himself which could be another reason to explain the ongoing unethical decision making at CBA.

Most decision that is made at CBA generally fall under the restricted egoism principle in which individual are motivated to act to promote self-interest, if action is legal and acceptable. This principle could see individual deceive and manipulate others for personal gain which is the status of CBA according the information reveal during the hearing.

Part 2

Corporate fraud represents a key problem amongst the companies, irrespective of their size, specific sector or else region wherein these same took place. In essence, corporate fraud comprises of various activities that are undertaken by way of company or else individuals which are undertaken in a manner that is illegal or else dishonest, as well as that they shall be designed for giving the advantages for the purposes of perpetrating the involved company or else individuals (Wu et al. 2016; Copp and Cronin 2018; Johnson et al. 2014). The schemes of corporate fraud shall go beyond overall scope concerning the stated position of employees, as well as shall be marked by way of the complexities as well as economic impacts over the business, various external parties, other employees, etc. Effectively corporate fraud could be highly challenging for being prevented as well as to be caught (Wu et al. 2016; Copp and Cronin 2018; Johnson et al. 2014). By way of creating, established and enforcing effective set of policies, comprehensive systems comprising checks, controls as well as balances and data / digital / physical security, concerned company could limit overall extent till which the fraud could take place (Wu et al. 2016; Copp and Cronin 2018; Johnson et al. 2014).

In this context, this report presents two different corporate cases of different types and undertakes evaluation to propose what could have been undertaken for preventing the same.

Corporate Fraud Case #1 – Kobe Steel – Data Fraud [2017]

Kobe steel made an admission for falsifying data pertaining to the quality concerning copper and aluminium parts that were supplied by it to various companies and the overall quantum of these supplies aggregated to 20,000 MT from four different plants (Soble and Boudette 2017; Kobe Steel Ltd 2017; Obayashi 2018). The company in a systematic manner fabricated the inspection related data concerning measurements as well as strength pertaining to the copper and aluminium products. This problem in addition extended across the Kobe group companies present across Japan as well as other nations and also other business units, that is, steel, and iron components, etc. (Soble and Boudette 2017; Kobe Steel Ltd 2017; Obayashi 2018). Numerous managers and workers had been involved to

carry out this fraud and the same has been proceeding for over five decades (Soble and Boudette 2017; Kobe Steel Ltd 2017; Obayashi 2018). The company's many products failed to meet the various quality / specification requirements and despite the same they were falsely confirmed to be complied with by way of these data within the inspection certificates being re-written in a fraudulent manner (Soble and Boudette 2017; Kobe Steel Ltd 2017; Obayashi 2018). These alterations, as has been confirmed by this Company, took place in about 4 per cent of its production outputs. In certain cases, required set of checks were failed to be undertaken. This misconduct had been found out at the time of internal inspections as well as by way of emergency quality audit undertaking (Soble and Boudette 2017; Kobe Steel Ltd 2017; Obayashi 2018).

Naturally, the outcomes of these findings were adverse and the company lost close to one third of market capitalization in just one week. Numerous law suits arising from the various affected parties spanning customers, investors, regulators, etc. across various nations also followed (Soble and Boudette 2017; Kobe Steel Ltd 2017; Obayashi 2018).

Corporate Fraud Case #2 – Banco Espírito Santo (“BES”) – Asset Misappropriation [2013]

Banco Espírito Santo, SA (“BES”) offers varied set of banking products as well as services and at its home location, BES operates in the form of single and largest of integrated network comprising branches, across more than 479 different locations all across Portugal (Farina et al. 2017; Sharife 2016; Hao et al. 2017).

In the later part of 2013 BES, at that time fifth of the biggest banks in Portugal, was undertaking discussion with respect to the increases concerning capital at the bank (Farina et al. 2017; Sharife 2016; Hao et al. 2017). The eventual failure of BES which caused significant losses for significant institutional investors and also innumerable small investors as well as retail customers of this bank rolled when the revelation was made that the parent entity of BES was going bankrupt (Farina et al. 2017; Sharife 2016; Hao et al. 2017). The fraud herein can be traced to BES having sold the debts of the parents entity to the retail customers as well as the huge proportion of BES's assets was comprised of the loans made

to the parent entity. The important aspect herein is that despite repeated calls made by Bank of Portugal, BES failed in reducing overall exposure to the parent entity and bank continued in financing non-financial organizations by way of the parent companies that was holding it (Farina et al. 2017; Sharife 2016; Hao et al. 2017). In summary, the family which owned BES required money for financing its various diversified range of business operations as well as consequently benefited by way of the unlimited capacity for raising capital by way of BES (Farina et al. 2017; Sharife 2016; Hao et al. 2017).

In essence, the parent entity abused its authority and defrauded innumerable investors and various stakeholders by misappropriating the assets held by BES (Farina et al. 2017; Sharife 2016; Hao et al. 2017).

Prevention

Even if frauds in and by corporates can be undertaken varied and different ways, as evidenced in the Kobe Steel company and BES, corporate fraud usually is undertaken by way of taking advantages of the confidential information or else accessing the sensitive assets, as well as then suitably leveraging / exploiting these assets for short term or illegal gain. The fraud can be noted to be hidden often behind the legitimate and systematic business practices / transactions for the purposes of disguising these illicit activities. To take an example, accounting / quality audits at these companies had been suitably altered for presenting the image that presents high revenue, high quality products, etc. or else plain simple broad day light robbery as in the case of BES. The actions undertaken by these companies can be traced to the motivations for hiding or preventing the shortcomings like that of net loss, slower growth / revenue, sales declines, expenses, business failure, etc. These falsified practices are essentially undertaken for making their respective company in being attractive for potential investors / buyers. Or as in the case of BES, even the mere survival fuels the fraudulent practices. Other modes of the corporate frauds aim in disguising or else misrepresenting the products / services, as in the case of Kobe Steel, thereby hiding the flaws / defects, making false representations, etc. Instead of investing to repair, refurbish, or else re-designing their products, the people responsible with respect to product strive in deflecting or else disguising these various issues. The same might be

undertaken in case the concerned company / department do not possess the finances for correcting the various problems or else if the revelation of these issue may drive away the customers as well as investors.

As it can be noticed in both of these cases, the fraud did not take place as an one off activity or undertaken in secrecy by one or few individuals. Rather, these frauds were undertaken in a systematic manner involving numerous internal employees as well as external consultants, etc. Most importantly, the senior management and governance committee were either aware of the issues or else be part of it or even mastermind the same. In these contexts any form of internal controls or else measures are never going to be sufficient. The most prudent approach in these cases shall be the role of external regulators and how effectively they can enforce the regulations and their compliances, how audits can be independent and how whistle blowing can be undertaken with least impacts to the whistle blower. Hence to prevent such frauds in future, regulatory bodies need be innovative and bring about practices, enforce them such that any deviations can be highlighted by way of audits, disclosures and representations. A high penalty in terms of financial fines, jailing and other such serious punishments shall be essential to send effective signals for preventing companies / individuals to undertake frauds in future.

This report undertook a detailed presentation and assessment of two corporate fraud cases – Kobe Steel Limited involving data fraud and quality misrepresentation, and, BES involving asset misappropriation by its parent entities. The assessment and evaluation led to the proposal of effective prevention strategies for such frauds in the future.

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