

# Bank Fraud and Preventive Measures in Nigeria: An Empirical Review

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## **Abstract**

This study examines the measures for fraud prevention in banking industry. Primary data were used for this study. This study was carried out by collecting data from 15 quoted commercial banks in Nigeria as at 31st December, 2015. The study utilized ordinary least square regression model. It was observed that strong internal control system, good corporate governance and compliance with banking ethics have positive and significant influence on fraud prevention in banking industry. This indicates that a commitment in the implementation of the variables of this study will reduce fraud, errors and misappropriations in the banking sector. The study recommended that banking institutions should establish and ensure effective and strict implementation of all these variables which is strong enough to prevent fraud, errors and misappropriations.

**Keywords:** Fraud Triangle, Internal Control System, Corporate Governance, Compliance with Banking Ethics.

## **INTRODUCTION**

Fraud is a threat to an organization's going concern and its interaction with external stakeholders such as customers, suppliers, financiers and business partners which can result in huge financial damage. Banking industries holds a critical position in the country's financial

system and plays a vital role in the development of a nation's economy. The banking sector increases the quantum of National savings and investments by being an intermediary between surplus and deficit spending units and hence national output (Ajala, Amuda&Arulogun, 2013). They influence the level of money supply which is indispensable in the growth of National income and serves as a determinant for the level of the country's economic activities through availability of credit (Etuks, 2011). Idolor (2010) and Akindele (2011) were of the opinion that banking sectors are the principal depositories of the public monetary savings and also the nerve center of the system of payments, owed with the money creation ability, allocation of financial resources and conduct through monetary and credit policies. Adeyemo (2012) opined that the success of any monetary and credit policy depends on the state of health of banking institution through which the policy are implemented. This means whatever issues or problems that go against the free flow or proper functioning of the sector will have a strong effect on other sector of the economy. Base on this, it is therefore of a great importance to quickly prevent or diagnose any factor that can hinder the smooth running of the banking sector.

However, if banks must perform efficiently, effectively and contribute meaningfully to the development of a country economy, the industry must be safe, stable and sound. For these to be achieved there is a need for a strong system of internal control, compliance with banking ethics and good corporate governance practices. Andrew (2008) observes that a strong system of internal control forms a very important component in banking management and a strong foundation for safe and sound operation of banking industry. Though as the technology advanced there is a need for them to look at other means to safeguard the industry from fraudulent activities and unethical behavior.

### **Statement of the Research Problem**

Association of Certified Fraud Examiners (ACFE) (2014) observes that the banking industry are becoming more and more susceptible to fraud over the years due to ineffective control measures been put in place, because fraudsters are now more skillful and versatile in designing other means of breaking these ineffective controls. KPMG (2009) opined that the key contributor to fraud occurrence is poor system of internal control while Beasley (1996) and ACFE (2014) were of the opinion that a poor corporate governance practice is the key contributor. Ajala, Amuda and Arulogun (2015) conclude that effective and efficient internal control system is the best measure for preventing fraud in the banking sector. But as banking industries move on with wide range of activities, fraud can therefore occur from both internal and external sources, which without missing words have negative effect on the organization's going concern. Therefore, banking industry should not limit itself to internal control and corporate governance alone as opined by various existing studies, but also ensure compliance with banking ethics, which is the knowledge gap this study tends to fill. In the light of the above, the following questions are asked:

1. To what extent can a strong internal control system prevents fraud occurrence in banking sector?
2. How does good corporate governance influence fraud prevention in banking sector?

3. To what extent does compliance with banking ethics prevents fraud in the banking industry?

### **Objectives of the study**

The broad objective of this study is to examine how fraud can be prevented in the banking sector. While the specific objectives are to:

1. ascertain the effectiveness of strong internal control system in preventing banking fraud;
2. examine the effect of good corporate governance practices on banking sector fraud prevention; and
3. Know whether strict compliance with banking ethics will help in the prevention of banking fraud.

### **Hypotheses**

- Ho<sub>1</sub>. Internal control system does not have any effect on preventing banking sector fraud.  
Ho<sub>2</sub>. Corporate governance practices cannot help in preventing banking sector fraud.  
Ho<sub>3</sub>. Compliance with banking ethics is not an effective tool for preventing fraud in banking sector.

## **REVIEW OF LITERATURE**

### **Concept of Fraud**

Fraud can be defined as an intentional act of deception aimed at getting an undue advantage at the expense of individual or organization losing properties or some lawful rights (Eseoghene, 2010). Federal Bureau of Investigation [FBI] (1984) also defined fraud as the fraudulent conversion and acquisition of resources or money through false pretense. The Association of Certified Fraud Examiners [ACFE] (1999) sees fraud as the use of one's occupation for personal enrichment through the deliberate misuse or misapplication of organization's asset or resources. Fraud in general terms is a representation of false statement to an individual or organization, which is believed and acted upon by the victim, which the victim suffers damage or loss.

Fraud at times can be in form of theft, misappropriation of assets and even manipulation of records and mostly backed-up by concealment of the theft. In other word, it is the conversion of stolen properties or resources. Onibudo (2007) concludes that for fraud to occur there must be three elements which he referred to as "WOE". This "WOE" mean the will, opportunity and exit (escape route), that is in-turn referred to as the fraud triangle, which is the perceived pressure, perceived opportunity and rationalization.

Fraud is not peculiar to banking industry alone, it is a general phenomenon. Some multinational organizations such Enron, Worldcom etc. has been affected negatively due to fraud occurrence, therefore many organizations has made so many attempts to restore their goodwill and images by instituting ethical guidelines and code of ethics to prevent unethical behavior.

Bank fraud can be committed in so many ways and most of the times it involves both insider (employee) and outsiders coming together to successfully commit an unethical behavior.

Ovuakporie (1994) observed that most of the common bank frauds are theft and embezzlement, defalcation, forgeries, unofficial borrowing, foreign exchange malpractices, impersonation, manipulation of vouchers, falsification of status report, money laundering, fake payments and computer fraud. The major causes of banking fraud are poor corporate governance, weak internal control and lack of compliance with banking ethics. Bank fraud greatly affects the growth of banks negatively and leads to bank distress because the existence of fraud can result to reduction of deposits from bank customers which in turn reduce their capital base. Asukwo (1999) observed that banking tend to cover up some fraud in order to continue gaining the customers' confidence and maintaining their goodwill all the time, but the long term effect of managing fraud instead of preventing it might be so dangerous for the institution's going concern.

### **Internal Control System and Fraud Prevention**

ICAN (2010) defines internal control as the whole system of control, financial or otherwise, established by the management in order to carry on the business of an enterprise in an orderly an efficient manner, ensuring adherence to management policies, safeguarding the assets and secure as far as possible the completeness and accuracy of records. Internal control as defined by the Commission of Sponsoring Organization [COSO] (2010) is the process established by an organization's board of directors and management, which is designed towards providing a reasonable assurance in order to achieve their aims and objectives in an efficient and effective manner, and ensuring reliability of their financial statement and in conformity with relevant rules and regulations. Campbell and Harther (2010) opined that internal control is established in order to put management on alert towards likely problems, to ensure they are being controlled before it got escalated to a big issue. Though these controls cannot totally eradicate all the errors and misappropriation but can minimize its occurrence.

The problems encountered by the financial institution nowadays are both financial and non-financial, and are mostly as a result of ineffective system of internal control. The antidote for the problems in banking industry is a strong system of internal control, many banks had failed due to lack of effective internal control (Tunji, 2013). Khanna and Arora (2009) observed that weak system of internal control is the loopholes that fraudsters normally identify before committing their unethical act. Hartman (2014) stated that banking industry has suffered so many losses because of weak internal control system. This makes it very important for banking institution to adopt strong system of internal control if they must eradicate or minimize unethical attitude both from internal and external environment. COSO (2013) identifies some assessment to fortify system of internal control to achieve objective of fraud prevention, some of these assessments are the risk assessment, control environment, information and communication and continuous monitoring.

### **Corporate Governance and Fraud Prevention**

Corporate governance is a set of mechanisms through which outside investors are protected from expropriation by insiders (including management, family interest and/or governments). It is essentially about the prevention of fraud or theft which can be craftily executed by either the

management or board or both of them (Institute of Chartered Accountants of Nigeria [ICAN], 2010). Corporate governance established three elements as monitoring mechanisms in ascertaining good corporate governance, which are directorship, internal auditing and external auditing (Anderson, Francis & Stokes, 1993). The fourth element was added by the Institute of Internal Auditors [IIA] (2003) which is audit committee. Unegbu (2003) sees corporate governance as the way and manner at which organizations are directed and managed for improving the value of the shareholders and for the enhancement of corporate performance and ensuring accountability, while taking into cognizance the interest of other stakeholders. Poor governance is one of the major factors that lead to fraud in the banking sector (Adeyanju, 2014). Hunkin (2002) opined that in a truly great organization, passion is tempered by good corporate governance and a constructive dynamics exist between the organization's management and the board of governance processes. He sees that an effective board would provide check and balances on management without being compromise to ensure fraud prevention.

### **Compliance with Banking Ethics and Fraud Prevention**

Ethics are the well-grounded standards of what is right and wrong which actually shows what individuals ought to do or not, majorly in terms of rights, obligations, benefits to society, fairness or specific virtues (Adeyanju, 2014). Aron (2006) sees ethics as those that carry some virtues such as compassion, honesty and loyalty. Therefore, ethics is not the same as feelings, religion, norms, science, values and morality but in general term it is an attempt to state or determine what is good, both for individual and society as a whole (ICAN, 2014).

Aron (2006) opined that banking ethics set out overall principles about the industry's belief on the issue such as quality, privacy, mission and their environment. The ethical issues involved here are the principles and values that are fixed, either explicitly or implicitly to guide behaviors of bankers against unethical behavior. Carse (1999) noted that code of ethics is very indispensable to both bankers and general public, banks are responsible for protecting the interest and rights of their numerous customers, establishment of stability and ensuring confidence in financial markets and economic development, this makes it very germane for banks to ethically go on with their day-to-day activities in compliance with the principle of impartiality, integrity, reliability, transparency, social responsibility and controlling money laundering in order to prevent fraud both from the inside and outside. The objective of setting ethical code of conduct is to enable bankers make their thoughts clear on what represent immoral and unethical conduct, this helps experts and professionals to know moral issues and figure out restrictions on what constitutes an acceptable or unacceptable attitude, towards curbing unethical behavior.

## **THEORETICAL REVIEW**

### **Theory of Fraud Triangle**

This theory entails the triangle of different fraud aspects which includes perceived pressure/motives, perceived opportunities and rationalization. The term perceived is important in the context because at times pressure, opportunities and rationalization may not be

necessarily real (Chiezey&Onu, 2013; and Ogechuckwu, 2013). Chiezey and Onu (2013) observe that the first temptations to commit fraud are financial and non-financial pressure. Though financial pressure is the major pressure as argued by Ngalyuka (2013), that 95% of frauds committed are due to financial pressure. This pressure can be in form of debts, underpayments, personal family financial challenges of the employees and those that related to work in terms of pressures to perform more than others (Ngalyuka, 2013).

The opportunity to commit fraud in the bank is determined by the undue access of the employees to some basic information which gives them an advantage to commit an unethical behavior and conceal it (Chiezey&Onu, 2013). Kanu and Okafor (2013) argue that these opportunities are due to weak control measures, lack of expectation for punishments which can serve as a deterrence and inadequate infrastructure.

The last factor in the fraud triangle is the perceived rationalization. Rationalization is the justification of an unethical behavior within an organization other than a criminal activity. Mahinda (2012) opined that individual who cannot rationalize its unethical behavior might probably not commit fraud.

From the argument above, it is glaring that beyond internal control and corporate governance, strict compliance with banking ethics has great potential for preventing opportunity and rationalization for fraud which in turn break the fraud triangle.

### **Agency Theory**

Onwujiuba (2014) noted that separation of ownership from management of a business concern without proper monitoring gives an opportunity for unethical behavior. The owner of the business must ensure that the employees work in the best interest of the shareholders, this can be achieved through the use of both financial and non-financial incentives to the employees (Onwujiuba, 2014). This incentives will ensure that the employee stayed motivated all times and thereby reducing the perceived pressure to commit fraud. This incentives can be inform of leave bonuses, medical insurance schemes, availability of staff loan, quick response to their need etc. (Mutesi, 2011).

It is a statement of fact that the contemporary materialistic tendencies have rendered ineffective the incentive packages in reducing agency cost which could be mirrored most of the times by fraudulent engagements of the agents (i.e. management). Hence, beyond internal control and corporate governance, compliance with banking ethics becomes imperative as far as banking industry is concerned.

### **Empirical Review**

Sang (2012) explore determinants of fraud control measures in Kenya commercial banks. Descriptive research design was used and data was collected through the use of questionnaire and analyzed using descriptive and inferential statistics. The study concluded that the effectiveness of internal control measures was affected by non-adherence to dual control aspect and lack of sufficient time to undertake the various periodic tests with delight. He recommended that comprehensive measure militating against fraud be established and

enforcement of compliance of fraud mitigation methods and increase the numbers of staff in key areas.

Ajala, Amuda and Arulogun (2013) examine the evaluation of internal control system as a preventive measure of fraud in Nigerian banking sector. Data was sourced from five commercial banks audited and published financial statements and were analyzed with the use of product moment correlation coefficient and regression analysis. They find out that internal control system has significantly prevented and curbed frauds in Nigerian banks. They concluded that bad corporate governance was responsible for improper designing of internal control system which could have led to corporate performance of Nigerian banks.

Zuraidah, Mohd and Yusarina (2015) investigated fraud schemes in the banking institutions and the preventive measure to avoid severe financial loss. The study was conducted among management levels in Malaysia banking institutions, with a focus on branch managers and assistants' managers who handles mortgage loan and hire purchase loan. The study finds out that perpetrators of fraud always have insight of the procedure and had taken advantage and capitalize on the process to penetrate and commit fraud. They concluded that it is impossible to achieve zero fraud risk in the banking institutions because fraudster will always find their ways, therefore that the fundamental functions of banking institutions' staffs should be better emphasized to make their roles more visible in combating fraud.

**METHODOLOGY**

This study employed the use of primary data and questionnaire as a tool for collecting data, the population of this study was made up of 15 commercial Banks listed on Nigerian stock exchange (NSE) as at December 2015, their Directors/Finance Managers, Branch Managers and Operations Managers, Compliance officers, Head of different units and Customers service officer were the respondents based on their experiences. A branch of each of the quoted banks was chosen at random to represent the entire branch in Nigeria, ten respondents each were selected from each of the quoted banks which makes it 150 respondents in total. This study uses simple random sampling technique. The instrument was an 8 – term survey questionnaire with a 4 Likert scale responses which are Strongly Agreed (SA), Agreed (A), Disagreed (D) and Strongly Disagreed (SD).

**Model Specification**

The dependent variable for the study is the Banks Fraud Prevention (BFP). The independent variables are Internal Control System (ICS), Corporate Governance (CG) and Compliance with Banking Ethics (CBE). For empirical analysis purpose, the study used Regression Model with Ordinary Least Square (OLS) Technique to test the relationship between the dependent and independent variables, in such a way that the results obtained from the regression analysis are used to make decision in order to reject or accept formulated hypothesis of the study.

The following models were specified in accordance with the objectives and formulated hypothesis in other to guide and capture the effect of independents variable on dependent variable on this study:

$$BFP = f (ICS, CG, CBE) \dots\dots\dots (i)$$

This is can be re-specified in a regression form thus:

$$BFP_t = \beta_0 + \beta_1 ICS_t + \beta_2 CG_t + \beta_3 CBE_t + u_t \dots\dots\dots (ii)$$

Where:

BFP = Banks Fraud Prevention

$\beta_0$ = Intercept/Constant,  $\beta_1, \beta_2, \beta_3$  are slope/coefficient,

ICS = Internal Control System

CG = Corporate Governance

CBE = Compliance with Banking Ethics

$u$ = Error term.

The Apriori signs are:  $\beta_1, \beta_2, \beta_3, >0$

**DATA ANALYSIS AND INTERPRETATION OF RESULTS**

**Table 1: Descriptive Statistics**

	N	Range	Mean	Std. Deviation	Skewness	Kurtosis
BFP	150	3	2.36	1.004	0.105	-1.029
ICS	150	3	2.46	1.002	0.062	-1.110
CG	150	3	2.39	1.014	0.104	-1.038
CBE	150	3	2.34	1.026	0.110	-1.160
Valid N (list wise)	150					

Source: SPSS Version 20.0

**Descriptive Statistic (Table 1)**

The descriptive statistics of the variables used in the analysis as presented in table 1 explains the range, mean, standard deviation and the normality of variables, Banks fraud prevention is the main variable of interest, which is the dependent variable. From the table banks fraud prevention had a mean value of 2.36 and the standard deviation is 1.004 which is a little close to the mean, this shows a low degree of variability of data. Banks Fraud prevention was positively skewed with a skewed value of 0.105 which shows it is normally distributed. All the explanatory variables are positively skewed which are Internal Control System (ICS), Corporate Governance (CG) and Compliance with Banking Ethics (CBE).

**Table 2: The Computation of (OLS) Result**

Variables	Coefficient	Standard error.	T-statistics	Probability
Intercept	3.574	0.247	8.968	0.000
ICS	2.165	0.120	3.865	0.017
CG	1.242	0.257	3.876	0.002
CBE	2.636	0.456	8.465	0.004
$R^2=0.682, R^2 \text{ bar}=0.634, F\text{-stat.}, (3,150)=31.172, \text{Pro}(F\text{-stat.})=0.000$ <b>D.W = 2.131</b>				

Source: SPSS Version 20.0

**OLS Analysis (Table 2)**



$$\begin{aligned} \text{BFP} &= 3.574 + 2.165 + 1.242 + 2.636 + U \\ \text{S.E} &= (0.247) \quad (0.120) \quad (0.257) \quad (0.456) \\ \text{T-Stat} &= \{8.968\} \quad \{3.865\} \quad \{3.876\} \quad \{8.465\} \end{aligned}$$

The intercept value shows 3.574 which means Banks Fraud prevention (FP) has 3.574 units when other variables are held constant. Internal Control System (ICS) shows that 1unit increase in internal control system will bring 2.165 unit increases in bank fraud prevention, and this is significant at 0.017, because it is less than 0.05 level of significance. Corporate Governance (CG) shows that 1unit increase in it will bring 1.242 unit increases in the bank fraud prevention, it is also significant at 0.002, because it is less than 0.05 level of significance. Compliance with Banking Ethics (CBE) shows that 1unit increase in it will bring 2.636 unit increases in the banks fraud prevention; it is also significant at 0.004, because it is less than 0.05 level of significance. The R-squared stand at 0.682 which shows the explanatory power of the model which can be seen as 68.2%, means 68.2% of changes in fraud prevention can be explained living 31.8% unaccounted for. The F – statistic shows the robustness of the model by comparing F-calculated to F-critical in order to explain the impact of whole explanatory variables on explained variable, and this was shown by looking at it from the angle of 0.01 and 0.05 level of significance which are 3.78 and 2.60 and are less than 31.172 calculated respectively, in terms of overall significance all independent variables showed a significant relationship with the dependent variable with the prob. (F-statistic) of 0.000. The Durbin Watson value of 2.131 is an indication of the absence of autocorrelation in the model.

### **Discussion of Findings**

Based on the OLS table above, the result shows about 68.2% of the systematic variation in BFP is explained by three independent variables (ICS, CG and CBE). This coefficient determination is strong and shows a good fit of the regression line as well as indicating the forecasting power of the model is strong. The F value of 31.172 is statistically significant at 5%. This means that ICS, CG and CBE have significant positive relationship with FP and this is in compliance with the apriori expectation. The results from the analyses above are indications that the independent variables have a significant impact on the banks fraud prevention. Literature is filled to satisfaction with a very wide range benefits these variables offers its adopters.

In considering the variables individually, Internal Control System (ICS) showed both positive and significant relationship with banks fraud prevention. This implies that the control measures taken by the management of banks will be effective in the prevention of fraud. This is in consistent with the findings of Nyakarimi and Karwirwa (2015).

Corporate Governance (CG) showed both positive and significant relationship with banks fraud prevention. This means effective corporate governance can help banks in the prevention of fraud, errors and misappropriation. Mohammad (2015) also found a positive and statistically significant relationship which is consistence with this finding

Compliance with Banking Ethics (CBE) was found to have positive and significant relationship with bank fraud prevention. This implies that, increasing compliance with banking ethical

standards can reduce unethical behavior in banks. This is line with the findings of Adeyanju (2014).

## **CONCLUSION**

This study reviews the measures that can be effective and efficient in preventing fraud in banking industry. This study concludes that strong internal control system, good corporate governance and compliance with banking ethics have significant influence on fraud prevention in the banking industry, this suggest that an increase in the effective use of these variables can help reduce fraud occurrence in banking institutions. Based on these findings, banking institutions are hereby advised to establish and ensure effective use of all these variables which is strong enough to stand against the trick of fraud and encourage smooth operations free from errors and misappropriations.

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