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DETERMINANTS OF FRAUD IN NIGERIAN BANKING INDUSTRY

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Abstract

Fraud and Forgery have been identified as major causes of bank distress and eventual failure in the Nigerian banking sector. Using the data from Nigerian Deposit Insurance Corporation (NDIC), the estimated multiple regression result shows that there exist a causal relationship among the total amounts, number of cases, number of fraudulent staff, and fraud and forgery activities in Nigerian banking sector. Hence, sound corporate governance characterized by effective operational practices comparable to international standards should be adopted by supervisory agencies of the financial system in Nigeria to prevent adverse effect of fraud on the economy.

Introduction

Fraud is a universal phenomenon that has been in existence for so long. Its magnitude cannot be known for sure, because much of it is undetected and not all that is detected is published. It is known facts that no area of banking system is immune to fraudsters not even the security system designed to prevent it. (Adewumi, 1986; Nwankwo, 1991). Fraud is a global phenomenon. It is not unique to the banking industry or for that matter, peculiar to only Nigeria. With the crash of multi-national corporations like Enron in 2001 (Bratton, 2002); coupled with high level allegations and actual cases of corporate fraud, many organizations in their attempt to improve their image have resorted to developing ethical guidelines and codes of ethics. The whole essence of these is to ensure that all organizational members irrespective of rank or status, complies with the minimum standard of ethical responsibility in order to promote the reputation of such firms in their chosen

industry, earn the goodwill of customers and thus improve their competitive advantage (Unugbro and Idolor, 2007).

Fraud, which literarily means a conscious and deliberate action by a person or group of persons with the intention of altering the truth or fact for selfish personal gain, is now by far the single most veritable threat to the entire banking industry. It is indeed worrisome that while banks are constantly trying to struggle with the demands of monetary authorities to recapitalize up to the stipulated maximum standards, fraudsters are always at work threatening and decimating their financial base. Also, more worrying is the rise in the number of employees which many escape detection thus encouraging many others to join in perpetrating fraud (Olasanmi, 2010; Gold, 2009).

The spate of fraud in the banking industry has lately become an embarrassment to the nation as apparent in the seeming ability of the law enforcement agents to successfully track down criminals. Whereas, the activities of armed robbers are given widespread reviews on the pages of newspapers, especially during major thefts, it is an irony that what they cart away from banks is only a piece of what fraudsters remove from bank tills. (Eseoghene, 2010). Statistics on the activities of fraudsters in the industry is both amazing and confounding. Ogwuma (1981) estimated that on the average, banks in Nigeria were at a risk of losing one million naira every working day due to the incidence of fraud which comes in different forms. In recent times, this estimate is low going by the Nigerian Deposit Insurance Corporation (NDIC) report where banks recorded cases of fraud and forgeries totaling 11.244 billion naira (Kazeem and Ogbu, 2002). Such an amount would have been enough to set up at least eleven Micro Finance Banks in the current period. Forgeries currently constitute the greatest challenge facing the industry. According to NDIC publication, about one thousand nine hundred and fourteen (1,914) bank staff of various banks were involved in bank fraud between 1996 and 1998. The report also established that fraud contributed immensely to the failure of most banks in the 1990s, the amount involved representing as much as 32.1% of shareholders fund in 1998 (Udegbumam, 1998). Equally worrisome is the rise in the number of top management staff that has ever been accused of engaging in bank fraud. It was because of the

incidence of fraud in Nigerian banks that led to the recent recapitalization of banks during the tenure of Professor Charles Soludo (former Central Bank of Nigeria Governor) in the year 2005.

This paper examined the effect of factors like: number of cases, number of fraudulent staff and the total amounts involved in fraud and forgery on expected loss due to bank fraud in Nigeria. The rest of the paper is divided into the following; section two covers conceptual framework, section three discussed data and model, while the result is presented in section four and finally, conclusion and recommendations.

Conceptual Clarification and Literature Review

In legal terms, fraud is seen as the act of depriving a person dishonestly of something, which such an individual would or might be entitled to. In its lexical meaning, it is an act of deception which is deliberately practiced in order to gain unlawful advantage. Therefore for any action to constitute fraud there must be a dishonest intention to benefit (on the part of the perpetrator) at the detriment of another person or an organization. (Eseoghene, 2010)

Fraud, can be seen as the intentional misrepresentation, concealment or omission of the truth for the purpose of deception or manipulation to the financial detriment of an individual or an organization (such as a bank) which also includes embezzlement, theft or any attempt to steal or unlawfully obtain or misuse the asset of the bank (Mahdi and Zhila, 2008). There is a general consensus amongst criminologists that fraud is caused by three elements "WOE" (Gold, 2009). For any fraud to occur, there must be a will to commit the fraud and if the opportunity to commit the fraud is available, then there will be an exit or escape route from relevant sections or institutions that are against fraud or related deviant behavior. As naturally expected, fraud is perpetrated in many forms and usually have insiders (staff) and outsiders conniving together to successfully implement the act (Nwaze, 2008). There are various types of frauds perpetrated in banks, according to Eseoghene, (2010), embezzlement is a form of fraud which involves the unlawful collection of monetary items such as cash, traveler's cheque and foreign currencies. It could also involve the deceitful collection of bank assets such as motor vehicles, computers,

stationery, equipment and different types of electronics owned by the bank. While defalcation, involves the embezzlement of money held in trust by bankers on behalf of their customers. Defalcation of customers deposits either by conversion or fraudulent alteration of deposit vouchers by either the bank teller or customer is the common form of bank fraud. Where the bank teller and customer collude to defalcate, such fraud is usually neatly perpetrated and takes longer time to discover. They can only, easily be discovered during reconciliation of customers' bank account.

Furthermore, forgeries are the fraudulent copying and use of customer's signature to draw huge amount of money from the customer's account without prior consent of the customer. Such forgery may be targeted at savings accounts, deposit accounts, current accounts or transfer instrument such as drafts. Experience has shown that most of such forgeries are perpetrated by internal staff or by outsiders who act in collusion with employees of the bank who usually are the ones who release the specimen signatures being forged (Nwazè, 2008). Impersonation involves assuming the role of another person with the intent of deceitfully committing fraud. Impersonation by third parties to fraudulently obtain new cheque books which are consequently utilized to commit fraud is another popular dimension of bank fraud. Cases of impersonation have been known to be particularly successful when done with conniving bank employees, who can readily make available, the specimen signatures and passport photograph of the unsuspecting customers. Another common type of fraud in the banking sector is fake payments, which involves the teller introducing a spurious cheque into his/her cage. It is done with or without the collaboration of other members of staff or bank customers. This type of fraud is however easy to detect if the bank has a policy of thoroughly examining all vouchers, cheques, withdrawal slips and payments on a daily basis.

Fraud, leads to loss of money, which belong to either the bank or customers. Such losses may be absorbed by the profits for the affected trading period and this consequently reduces the amount of profit, which would have been available for distribution to shareholders. Losses from fraud which are absorbed to equity capital of

the bank impair the bank financial health and constraints its ability to extend loans and advances for profitable operations. In extreme cases, rampant and large incidents of fraud could lead to a bank's failure.

Fraud can increase the operating cost of a bank because of the added cost of installing the necessary machinery for its provision, detection and protection of assets. Moreover, devoting valuable time to safeguarding its assets from fraudulent men distracts management. Overall, this unproductive diversion of resources always reduces output and low profits which in turn could retard the growth of the bank. It also leads to a diminishing effect on the asset quality of banks. The problem is more dangerous when compounded by insider loan abuses. Indeed, the first generation of liquidated banks by NDIC was largely a consequence of fraud perpetrated through insider loan abuses. If this problem is not adequately handled, it could lead to distress and bank failures.

The financial industry has adopted several measures to control occurrence of fraud. Mahdi and Zhila (2008) argued that measures aimed at fraud prevention include dual control, operational manual, graduated limits of authority, lending units, reporting systems, close circuit television, establishment of inspectorate units, segregation of duties, verification of signatures, controls of dormant accounts, detection of passport sized photos, close watch on the lifestyle of staff and coding/decoding and of telex messages. Moreover, measures aimed at fraud detection include checking of cashiers, call-over, reconciliation and balancing of accounts at branches, inter-bank at head office levels, periodical submission of statement of accounts, stock taking of security items and cash in the vaults and inspection by bank inspectors (Eseogheni, 2010). Olasanmi (2010) reveals that another angle to fraud prevention is the adoption of computer aids as a tool for fraud prevention and control. That is the involvement of management information system (MIS). She stated that good computer software will allow auditors to cover more grounds in less time and will also enhance the production of a more accurate report.

Methodology

Data used were obtained from secondary sources which comprises of Nigeria Deposit Insurance Corporation's (NDIC) annual reports of various years from 1990 - 2009. Data on the total number of fraud cases, total amount involved, number of staff involved and the total expected loss in fraud and forgery were extracted from them for estimation of the model.

A multiple regression analysis was used since we have more than two variables and the model is stated as thus:

$$Y = a_0 + a_1TAI + a_2NOC + a_3NSI + \dots \quad 1$$

Where a_1 , a_2 , and a_3 are the regression co-efficient and Y = Expected Losses (Dependent variable)

TAI= Total Amount Involved (Independent variable)

NOC = Number of Cases (Independent Variable)

NSI = Number of Staff Involved (Independent Variable)

Results and Discussion

The multiple regressions results show that the adjusted R-square value is 0.751 (i.e. 75.1%) which means that the estimated linear relationship has a high explanatory capacity (see table 1 below). That is, 75.1% of losses due to fraud and forgery activities in the banking industry is caused by the three variables (total amount, number of cases and staff involved), while 24.9% is caused by other unspecified variables. It was found that number of fraud cases and total amount involved are statistically significant at 1% level of confidence; as the determinants of expected loss due to fraud while the number of staff is not a statistically significant factor.

Furthermore, the study shows that as the amount involved increases, the expected loss increases with 0.219 (21.9%), although the increment is not that high. Positive sign shows that there is a positive relationship between the amount involved and the expected loss which implies that the total amount involved will affect the operations of the affected banks (Olasanmi, 2010).

Moreover, the number of cases has a high effect to the expected loss. That is, it has the highest value out of all the

independent variable. As the number of cases increases, the expected loss increases by 2.561, this also implies that the number of cases has a significant effect on banks' performance. That is, there is a high positive relationship between expected loss and the number of fraud in the banking sector of Nigeria.

However, for the number of staff involved, it has a negative statistical coefficient value which means that as number of staff involved decreases, the expected loss increases with -0.061, this may be due to huge sum of money usually involved in small number of top management staff that are involved in fraud. Although, it is not statistically significant even at 10% level of confidence, it confirms that the number of staff do not contribute to the level of losses due to fraud and forgery activities (Gold, 2009).

Table 1: The multiple regression results of the factors affecting expected losses due to fraud.

Explanatory Variables	Coefficient (t-value)	Other Statistics
Intercept	- 2417.381(-7.501)*	Adjusted R ² = 0.751
Total Amount Involved (TAI)	0.291 (13.426)*	F-statistics = 10.040
Number of Cases (NOC)	2.561 (6.824)*	Durbin- Watson = 1.91
Number of Staff Involved (NSI)	-0.061 (-0.346)	

Source: Authour's Computation 2011

1. * indicates Statistical Significant at the 1% levels of confidence.
2. Figures in parentheses are the t-value statistic.

Conclusion and Recommendations

Conclusively, this study confirm that expected loss due to fraud in the Nigerian Banking Industry are affected mainly by number of fraud cases and total amount involved, while the number of staff involved also contributes to the loss it was found to be statistically insignificant. Based on the above findings, the study recommends improvement in

the following area: that management should not hesitate to come to the aid of employees, any time there is a genuine financial request particularly in emergency situations. Such assistance does not only eliminate the tendency to defraud the organization, but helps to cultivate a group of dedicated and highly positive workforce. Also, in recruiting key personnel who are to handle certain sensitive operations, it is essential that banks make efforts at conducting a proper background check on the status and nature of the employee in his or her neighborhood as this would help them establish the probability of the employee engaging in fraudulent activities. Moreover, Sound corporate governance characterized by effective operational practices comparable to international standards should be adopted by top management of banks as an essential ingredient for the prevention of fraud in the banking sector. Top management must also strive to maintain a high degree of ethical standards in the performance of its duties in view of the fiduciary nature of their functions. This is imperative as they are required to safeguard the assets of their banks.

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