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CONTENTS

Articles

	Pages
1. Reflections on the Imperative of Transparency and Accountability for Good Governance — <i>Prof. A. E. Davies</i>	1
2. An Empirical Analysis of the Risk Profile of Quoted Firms in the Nigerian Stock Market — <i>Samuel Bayode Oludoyi</i>	8
3. An Empirical Investigation into Generic Competencies as Predictive Characteristics of Managerial Effectiveness — <i>Dr. J.A. Adeoti & Dr. Remi H. Samuel</i>	21
4. Managing the Nigerian Rural Environment for Sustainable Development through Participatory Rural Appraisal — <i>Dr. R. A. Olawepo</i>	32
5. Conceptualising National Interest and National Security in Nigeria: A Strategic Perspective — <i>Dr. (Mrs.) A. J. Omede</i>	40
6. Determinants of Unemployment and Labour Market Efficiency in Nigeria — <i>Dr. J. A. Bamiduro</i>	51
7. Strategic Management Option for Sustainable Public Transport Corporation — <i>Dr. Olujide Jackson & Adeoti J. O.</i>	59
8. Changing Structure of Intra-Urban Road Network in Ilorin, Nigeria (1963-1999) — <i>Dr. A. J. Aderamo</i>	65
9. Commercial Banks' Credits and non-oil Export Promotion in Nigeria — <i>M. A. Ijaiya</i>	75
10. Job Satisfaction among Employees in Kogi State Civil Service — <i>Bamidele Adeboye Adepoju & Memuna O. Audu</i>	84
11. The Impact of Aggregate Fiscal and Monetary Policy Instruments on Counter-cyclical Policy Objectives in Nigeria - A Preliminary Examination — <i>Dr. G. O. Atoyebi</i>	94
12. New Product Planning and Development: A Veritable Tool for Competitive Advantage — <i>M. A. Aremu</i>	103
13. Fraud in Nigeria's Financial System: Evidence from Commercial Banks — <i>M. A. Ajayi</i>	111
14. Chemical Characteristics of Shallow Wells in Ibadan North East L.G.A, Oyo State — <i>I. P. Ifabiyi</i>	118
15. Ethno-Religious Conflicts and Political Instability in Nigeria — <i>E. E. Lawal</i>	124
16. Drainage Problems in a Tropical Environment: Perspectives on Urban Quality Management — <i>Dr H. I. Jimoh</i>	133
Research Note	
17. Selection and Formulation of a Research Problem — <i>Dr. Adebisi Adedayo</i>	141

Fraud in Nigeria's Financial System: Evidence from Commercial Banks

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Abstract

The Nigeria economy loses a significant amount of money to fraudsters coupled with loss of confidence in the Nigerian banking sector over the years despite various preventive and detective measures put in place. This work identifies the contributory factors to the actual/expected losses. Multiple regression analyses were carried out to determine the significance and extent of the relationship in the model specified. The study reveals that the number of staff and branch network of the commercial Banks, categories of Staff involved in fraud have significant impact on the level of actual/expected financial loss. It is therefore recommended that supervision of bank employees and necessary investigations at the hiring point of the employees should be properly considered in commercial banking industry.

Introduction

All banks in the country including the Central Bank of Nigeria (CBN) seem to be under siege by men of the underworld, with or without insiders collusion. The reason for this occurrence is not far from the fact that Banks are among the richest organization in any country due to the nature of their business, which include purchase, storage and sale of money.

In view of the insatiable search for money in Nigeria, big time fraud is on the increase and the banks lose huge amount running into billions of naira to fraudsters. CBN bulletin reported that in 1991 the total amount involved in fraud was 388.51 million, which increased by 874 percent in 1994. By 1999, it stood at 7.386 billion, while in 2001 it has increased to 11.243 billion. Even where the frauds are detected early, amounts already drawn are difficult to recover.

The free flow of funds in a market environment has been made easier especially with innovations in electronic wire transfer. The process has further been entrenched by the liberalization of the economies of many countries in Eastern Europe, which have now adopted free market economic structures for their development. This has complicated the process of detection and prevention of fraud in Nigeria.

There appears to be little doubt that frauds in banks are a matter of the greatest concern to bankers, the monetary and political authorities and the generality of Nigerians today. Moreover every incidence of bank fraud literally chips off a bit of the public confidence that in turn adversely affects people's banking habits in Nigeria.

In February 1997, over 4 million suspected scam letters were intercepted by the Nigerian postal service; about five million letters were sent back to Nigeria from about 12 countries for allegedly being postmarked by forged franking machines. Moreover the Central Bank of Nigeria (CBN) spent \$4-\$5 million in both material and financial resources in the fight against this scourge and placed advisory advertisement in over 80 newspapers and magazines in 12 international languages (Adamu 1997: 15).

Distress and failure are hard facts of corporate life worldwide. However, some of such failures are episodic and often associated with serious scandals. We had the episodic failure of Johnson Matheys Bank (JMB), Long-Term Capital Management (LTCM) of the 1980s and 1990s. The most epoch-making scandal so far in the 21st century is that associated with ENRON (an Energy giant in America) that collapsed in 2002 (Victor 2002: 42).

Furthermore, the consequences of illegality and unethical behaviours and the exceedingly high cost on the nation's financial resources calls for the greatest attention. The dubious role of banks in the ENRON-saga facilitated by the removal of the statutory barriers between Commercial Banking, Investment Banking and Insurance raises concern about the advent of universal banking coupled with the weak corporate governance in Nigeria. There is also the issue of the high cost of corporate scandal that includes loss of jobs, loss of income, criminal prosecution, and erosion of corporate and individual reputation.

All these facts corroborate the biggest national question about the composition of the bank fraudsters and how bank fraud could be best prevented. Also fraud is a number one enemy to all concerned with the growth and development of our banking industry.

This paper sets out to empirically examine the structure of Nigerian commercial bank fraud and other contributory factors to the loss associated with fraud in the Banking sector. The paper concludes with policy options and recommendations.

Theoretical Framework and Literature Review

According to Fagbemi (1986:30)

"fraud is every act of unfair dealing whether against the bank by its customers or by third parties, against the customer by the bank (including its officers, etc); or indeed against the bank by its officers etc".

Adewumi (1986:1), describes fraud as a conscious premeditated action of a person or group of persons with the intention of altering the truth and/or fact for selfish personal monetary gain.

The above definitions show the episodic nature of this concept and confirm the importance of this nature of research work. The frauds in banks nearly always lead to loss of monies that ordinarily belong to someone other than the banks.

More over, various authors such as Adewumi, (1986; 1-4), Musa (1986; 1-13), and Sydney (1986; 21); identify fraud as an action usually taken the form of forgery, falsification of documents and authorizing signatures and outright thefts, negligence and suppressions of cash lodgement.

However according to Michael (1977; 23), the Differential Opportunity Theory which is one of the major essential theories of fraud states that employees have the opportunity of committing fraud against any of the following

- (a) Their employer
- (b) Suppliers and customers of their employer
- (c) Third parties
- (d) Government departments

He argued that this act is governed by three main factors:

The access the perpetrator has or can contrive to premises, accounts, assets and increasingly more important, to computer system.

- ♦ Skill in identifying the opportunity and exploiting it.
- ♦ Time in planning and committing the fraud.

He further stressed that access to fraud opportunities is the most important, depending on two conditions:

- i That authorized access granted through employment will achieve "Breach of trust" fraud.
- ii No access condition will cause the fraudster to access contrived by skill or collusion.

This study evaluates the corporate fraud that occurred through breaches of trust by bank's employees and others to whom access is granted.

Methodology

(a) Data Source

The data on Commercial Banks in Nigeria were considered for this research work because this banking sector controls over 60% of Assets and Liabilities of the whole Nigerian financial system. The researcher used secondary source of data. Data were obtained from the annual publication of Nigerian Deposit Insurance Corporation and Central Bank of Nigeria. The periods from 1989 to 2001 were considered for analyses because that is the period for which data were available.

(b) Model Specification

This study adopts derived models as shown below

$$W = F(x_1, x_2, x_3) \dots \dots \dots 1$$

Where

W = Actual/Expected losses associated with Fraud

x_1 = Total Amount Involved in Fraud

x_2 = Number of Commercial Bank's Staff involved in Fraud

x_3 = Branch Network of Commercial Banks

The actual/expected losses represent the financial loss to the national economy.

A multiple regression relationship was established as follows:

$$W = \beta_0 + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 \dots \dots \dots 2$$

Where $\beta_0, \beta_1, \beta_2, \beta_3$ are parameter estimates.

The second model states that:

$$W = F(Z_1, Z_2, Z_3, Z_4) \dots \dots \dots 3$$

$$W = \alpha_0 + \alpha_1 Z_1 + \alpha_2 Z_2 + \alpha_3 \dots \dots \dots + \alpha_4 Z_4 \dots \dots \dots 4$$

Where $\alpha_0, \alpha_1, \alpha_2, \alpha_3, \alpha_4$ are estimated parameters and

Z_1 = Supervisors and Managers

Z_2 = Clerks and Cashiers

Z_3 = Officers and Accountants

Z_4 = Typists and Technicians.

These models were formulated and tested by multiple regression analyses. The F values were calculated to determine the extent of relationship between the variables under

consideration. The level at which the relationship were significant are also determined. The coefficients of determination R^2 were equally obtained to confirm the explanatory capacity of the independence variables with respect to variation in the dependent variable. The Durbin-Watson test carried out was to determine the extent of auto-correlation and to establish the possibility of absence of one or more explanatory variables. All these were presented as a summary under Analysis of variance tables.

Interpretation of Results

The result from SPSS package on computer gives
 actual/expected loss = $2121.032 + 0.257X_1 + 3.427X_2 - 1.732X_3$
 S.E (1831.945) (0.062) (1.186) (0.962)
 T-cal 1.158 4.122 2.889 -1.800

Table 1: ANOVA TABLE for Model 1

Model	Sum of Squire	Df.	Mean Squire	F	Sig.	R^2	D-W
1 Regression	4459130.173	3	1486376.724	6.187	0.014	0.673	1.717
Residual	2162047.472	9	240227.497				
Total	6621177.645	12					

Source: Authors computer print out 2003.

ANOVA Table 1 shows that the estimated relationship between the expected/actual loss and other independent variables such as amount involved in fraud, total number of staff involved in fraud in Commercial Banks and their branch network were significant at 1% i.e. at 99% level of confidence with F-cal value of 6.184. The Durbin-Watson test carried out shows a value of 1.717 that is approximately 2. This result confirms the presence of auto-correlation, which can be ignored even though it shows that one or more explanatory variable in the model, is omitted. Nevertheless, the value's closeness to 2 suggests that those variables omitted are not significantly important.

The independent variables only explain about 67.3% of total variation in actual/expected loss due to fraud as given by the value of R^2 of the regression estimate. This shows that other variables contribute 32.7% of the total variation in actual/expected loss. These other variables may include: time lag between fraud perpetration and fraud detection, technology involved in fraud transaction and death of fraudster.

Apart from the significance of the whole relationship, specific parameters were tested to confirm the reliability of each parameter estimate. All the parameters were significant at 10%, while parameters β_1 and β_2 were significant even at 1%. This is because the calculated t is greater than the t-tabulated as stated above in the parentheses.

The parameters β_1 and β_2 are positive, suggesting that either an increase in amount involved in fraud or an increase in number of staff involved in fraud will automatically increase actual/expected loss and vice versa.

The parameter for branch network has a negative sign, which shows that as branches of Commercial Banks increase the level of expected/actual loss will reduce. The reason for this negative relationship is that as more branches are opened more staff will be

fulfilled in terms of proper placement in occupational position that reduces tendency to steal from banks treasury.

The second multiple regression analysis tested the relationship between expected financial loss from fraud and independent variables that represent various numbers of staff involved in fraud at various level of employment in Commercial Bank industries in Nigeria. These categories were identify as

Z_1 = Supervisors and Managers

Z_2 = Clerk and Cashier

Z_3 = Officer and Accountant

Z_4 = Typist and Technicians.

The ANOVA table below presents the result from SPSS package on the second model.

Table 2: ANOVA TABLE for the Model 2

Model	Sum of Square	df	Mean Square	F	Sig.	Adj. R ²	D-W
1 Regression	3991218.163	4	997804.534	3.035	0.085	0.404	2.153
Residual	2630030.571	8	328753.821				
Total	6621248.707	12					

Source: Authors computer print out 2003.

The result confirm that the estimated relationship of

$$W = 835.783 - 1.88Z_1 - 8.67Z_2 + 7.69Z_3 + 28.82Z_4 \dots\dots\dots 6$$

$$SE \quad (558.683) \quad (4.687) \quad (3.298) \quad (6.858) \quad (15.41)$$

$$t\text{-cal} \quad 1.496 \quad -0.401 \quad -2.631 \quad 1.123 \quad 1.872$$

The estimated multiple regressions are significant at 10% i.e. at 90% level of confidence as the value of F-cal is 3.035. The Durbin-Watson test was equally carried and shows a value of 2.153 that is approximately 2. This result also confirms the presence of auto-correlation, which can be ignored even though it shows that one or more explanatory variable in the model, is omitted. Nevertheless, the value's closeness to 2 suggests that those variables omitted are not significantly important.

Discussion of Results

These results confirm that frauds in banks are achieved "breach of trust" fraud. The relationship established that the structure of staff involved in fraud has significant effect on expected/actual losses due to fraud.

The structure of staff involved in fraud can explain only 40.4% of total variation in expected/actual loss associated with fraud as shown by the value of the adjusted R² on the ANOVA table in Table 2.

Further analysis carried out on the parameter testing reveals that the number of staff in the categories of supervisor, manager, clerk and cashier has negative relationship with expected loss due to fraud. This shows that, as the number of staff in these category

increases, the level of financial loss reduces. The reasons might have been that these categories of staff usually have enough assets and other financial resources to repay whatever they might have defrauded the bank. Another reason might be due to their social status, which they may want to maintain after being discharged, which may encourage them to refund large part if not all defrauded funds. These categories form the largest percentage of staff involved in fraud during the period under consideration in Nigeria commercial banking industry they are as high as 236 in 1991 and 218 in 1996.

The parameter for clerk and cashier is significant at 5% while that of supervisor and manager is not significant.

However, the other categories like number of staff involved in fraud like officers, accountants, typists and technicians have positive relationship with the expected/actual loss due to fraud. The reasons for this result is not far fetched because the skill involved in fraud detection are designed by accountants and technicians. Therefore it is usually difficult if not impossible to detect fraud perpetrated by these categories of staff, which accounts for the high expected/actual loss.

The parameter for typists and technicians were significant at 10% while that of officers and accountants is not significant.

Conclusion and Policy Recommendation

The foregoing analysis shows that various variables contribute to the variation in expected/actual financial loss due to fraud in the commercial Banking sector of Nigeria. These variables include number of staffs involved in fraud, the categories of staffs involved in fraud, the level of branch network of commercial banks and amount of money involved in fraud.

The factor that aids the intensity of fraud is the collaborative effort of employees at different stages in commercial banks which reduce the effectiveness of the internal control system of the banks. Other factors include lack of proper supervision from the relevant Monetary Supervisory Authorities, weak conception of job security by employees and the "get rich quick" syndrome that characterizes most employees in Nigeria due to high poverty level and people's perception of success.

The following policy recommendations are suggested for the Government and the Commercial Banks in Nigeria.

- ♦ Commercial Banks should not fail to check the background of potential employees.
- ♦ Social pressures may increase the justification for crime and changes in the complexity of commerce affect criminal opportunities. Therefore, supervision of financial transactions in banks must be intensified by the appropriate authorities like NDIC and CBN.
- ♦ The speed and efficiency of international communication means that a fraud that has been successful in Washington can be copied the next day in London. Hence, commercial banks' management team must be on their toes to curb the menace of copying fraud technicalities from developed world to Nigeria.
- ♦ An organization such as the Credit Industry Fraud Avoidance System (CIFAS) should

be established in Nigeria in order to bring together, all the financial institutions in Nigeria to fight against fraud in the financial service sector. This institution will provide databank of known fraudsters from all the financial institutions.

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