

Banking and Accounting Issues

Chapter 3

Overview of the Concept of Fraud in the Nigeria Banking System

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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. Fraud however has been defined by many scholars; Olufidipe (1994) defined fraud as deceit or trick deliberately practiced in order to gain some advantages dishonestly. According to Boniface (1991), fraud is described as any premeditated act of criminal deceit, trickery or falsification by a person or group of persons with the intention of altering facts in order to obtain undue personal monetary advantage. Another scholar Idowu (2009) also sees fraud as a deliberate falsification, camouflage, or exclusion of the truth for the purpose of dishonesty/stage management to the financial damage of an individual or an organization.

Fraud literally 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 (Ajayi, 2010). The word fraud means deceit, a trick, dishonest practice or a breach of confidence. The Oxford Advanced Learner's English Dictionary defines fraud as a criminal deception. That is to say, a fraud is any act of deception which is deliberately practiced in order to gain something dishonestly. Therefore, for any action to constitute a fraud there must be a proof of dishonest intention to benefit one major person at the expense of the other. According to Robertson (1996) fraud "consists of knowing or making material misrepresentation to a fact with an intention to inducing someone to believe to suffer a loss or damage. Fraud, involves the use of deception to obtain an unjust or illegal financial advantage (Okezie 1995). Agbadua (1980) as cited in Ogidefa, (2008) also opined that fraud is an anti economic process and must properly be dealt with. Fraud is a virus which spreads from the banking sector to other economic activities and organization even the government.

Williams (2005) describe fraud to include bribes, cronyism, nepotism, political donation, kickbacks, artificial pricing and frauds of all kinds. According to Agwu (2013), fraud is any illegal act characterized by deceit, concealment, or violation of trust. These acts are not dependent upon the threat of violence or physical force. Frauds are perpetrated by parties and organizations to obtain money, property, or services; to avoid payment or loss of services; or to secure personal or business advantage. It has also been viewed as an illegal act involving the obtaining of something of value through willful misrepresentation. According to another definition, fraud is to create a misjudgment or maintain an existing misjudgment to induce somebody to make a contract (Arzova 2003). Akinyomi (2010) view fraud as the act of depriving a person underhandedly of something, which such a person would or might be entitled to but for the perpetration of fraud in its lexical meaning, fraud is an act of trickery which is intentionally practiced in order to gain illegitimate advantage. Therefore, for any action to constitute a fraud there must be deceitful objective

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to benefit (on the part of the perpetrator) at the disadvantage of another person or group. Fraud typically requires stealing and manipulation of accounts, frequently accompanied by cover up of the theft. Chakrabarty (2013) defines fraud as any behavior by which one person intends to obtain a dishonest advantage over another where the person makes an illicit gain while the other party incurs a loss.

Curtis (2008) argues that fraud encompasses the acquisition of property or economic advantages by means of deception, through either a misrepresentation or concealment. Fraud is the act of intentionally deceiving someone in order to gain an unfair or illegal advantage (financial, political or other). The primary responsibility for the prevention of fraud rests with both those charged with governance of the entity and management. It is important that management, with the oversight of those charged with governance, place a strong emphasis on fraud prevention, which may reduce opportunities for fraud to take place, and fraud deterrence.

Fraud can also be defined as the use of deception to obtain an unjust or illegal financial advantage. The internal control auditing guidelines (number 11) describe fraud as; misappropriation of fund; Misapplication of assess; Recording of transaction with substance (source documents); Misapplication of accounting management policies; and Suppression and omission of the effect of transaction from records and documents. Other forms of fraud include, bribery, carryover fraud, electronic media fraud, alteration of invoice, double payment involve, false declaration, teaming and lodging, actual theft cash balance, forgery. Because fraud negatively impacts organizations in many ways financial, reputational, and through psychological and social implications it is important for organizations to have a strong fraud prevention program. It should include awareness, prevention, and detection programs, as well as a process to identify risks within the organization. To prevent fraud, it is necessary to build controls in all the five areas of resources namely; man power, machinery and time factor (Akpyomare, 1996).

Curtis (2008) stated that fraud encompasses the acquisition of poverty or economic advantages by means of deception, through either a misrepresentation or concealment. Fraud is the act of intentionally deceiving someone in order to gain an unfair or illegal to stress that the primary responsibility for the prevention of fraud rests with those charged with governance of the entity and management with the oversight of those charged with governance, place a strong emphasis on fraud prevention which may reduce opportunities for fraud to take place and fraud detriment.

Benjamin (2011) viewed fraud as simply a conscience and premeditated action taken by a person or group of persons to gain monitory asset from an organization or enterprise. It involves the use of decent and trick to forge or falsify document and signature in order to steal. He contrived by highlighting incidences of where fraud will manifest, which among others over unauthorized overdraft, presentation of forged cheques, posting of fictitious credit, suppression of cheques and a host of others. He further remarked that experience has shown that many of the above type of fraud can success without insider connivance and collaboration. Insider collaboration may be intentional or unintentional this is why sometimes, innocent/staffs when fraud occurs collaborate deliberately or deliberately ranges from lack of adherence to laid down procedures to deliberate distortion defection, interception, misappropriation and diversion of assets. He gave few instances of fraudulent practices to enable his audience differentiate between collaboration that is intentional and one that is not intentional.

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EFCC Act (2004) defines fraud as illegal act that violates existing legislation and these include any form of frauds, narcotic drugs, trafficking, money laundering, embezzlement, bribery, looting and any form of corruption malpractices and child labour, illegal oil bunkering and illegal mining, tax evasion, foreign exchange malpractice including counterfeiting currency, theft of intellectual property and piracy, open market abuse, dumping of toxic waste and prohibited goods (Aduwo, 2016). This definition is all embracing and conceivably includes financial crimes in corporate organization and these discussed by various authors (Khan 2005, William, 2005). The institute of professional practices framework Sommer (2014) defines fraud as any illegal act characterized by deceit or concealment or violation of trust which do not directly depend on the use of violence perpetrated in firms to obtain money, property or services to avoid payment or less of services or to secure personal or business advantage.

Okafor (2004) noted that fraud embraces all the multifarious means which human ingenuity can devise, which are resorted to by an individual to get advantage over another in false representation. No definite and invariable rule can be laid down as a general proposition defining fraud as it includes surprise, trick, cunning and unfair ways by which another is cheated fraudulently. Ramamoorti (2007) argue that fraud is a human endeavor involving deception, purposeful intent, intensity of desire, risk of apprehension, violation of trust and rationalization. It is therefore important to understand the psychological factors that might influence the behavior of fraud perpetrators. The rationale for drawing on behavioural science built on evident from the intuition that one needs to think like a crook to catch a crook. Fraud impacts organizations in several areas including financial operational and psychological. While the monetary loss owing to fraud is significant, the full impact of fraud on an organization can be staggering. The losses of reputation, goodwill and customer relations can be divesting. As fraud can be perpetrated by any employee within an organization or by those from the outside, it is important to have an effective fraud management program in place to safeguard organizations assets and reputation.

Types of Fraud

There are different ways of which authorities have classified fraud depending on their perspectives and the criteria used. Some classified them into management and employees fraud, others on the other hand, classified them on the nature and the perpetrator cases of fraud according to perpetrators as mentioned above is then divided into two categories whether the fraudster is one of the entire staff or involve outsiders, and whether the staff fraud fraudsters are in top management position or non- management position. The former is now divided into:

- i. Internal fraud
- ii. External fraud
- iii. Mixed fraud

While the later according to Nwankwo (1991) gives rise to :

- a. Management fraud
- b. Employment fraud

I. Internal Fraud

Internal frauds are frauds committed among the member staff of the bank. Frauds are not only most frequently occurring but for the highest in terms of number than the type

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involving both staff and outsiders (NDIC, 2005). The following listed methods according to Jenfa, (1991) are categorized as the internal fraud.

1. Unofficial borrowing
2. Over invoicing
3. Unauthorized stamps
4. Fictitious transactions
5. Fraudulent use of document
6. Cash on hand converted to personal use
7. Premature writing off of assets
8. Ghost names
9. Figures falsification

II. External Fraud

There are three types of fraud committed wholly by persons and organizations external to the bank i.e people and organizations other than or without the involvement of the bank staff persons such as these could be bank customers or those who do not do business with these banks such as;

Over-Invoicing: Over invoicing of services rendered to banks are done by dubious supplier and other contractors either through inflation of normal rates over actual value of services rendered or through committee with bank employees to get pay for services they already have been paid for (Omachonu & Ndulor 2008; Idown 2009).

Advance Fee Fraud: This may involve an agent who approaches a bank, with an offer funds at below market interest rates often for long term. The purported source of such funds is not specially identified as the only way to have access to it, it is also known as the way by which the agent disappears as the facilities engaged in never come through (Ornachonu & Ndulor 2008). Examples include.

- a. Schemes ostensibly for the disbursement of money for mills
- b. Contract Hands
- c. Purchase of real estates
- d. Transfer of funds

Loan Fraud: Loan and other form of credit extensions to business and individual customers constitute traditional functions of financial institutions. In the process of credit extensions, fraud may occur at any stage, from the first interaction between the customer and the bank to the final payment of the loan. Loan fraud occurs when credit extended to non-borrowing customers or to borrowing customers who has exceeded his credit ceiling. The fraudulent aspect of this class is that there is an intention to conceal it from the inspectorate staff on routine check to deceive them with plausible but falsified statements and documents. On some instances, loans are granted of false collaterals that are not existing overvalued, stolen or counters or counterfeited improper loans may also be granted to insider, relatives and friends of corrupt bank officials who collect kick backs such transactions (Ornachonu & Ndulor, 2008).

III. Mixed Fraud

This is categorized under management and employees fraud.

Management Fraud: This type of fraud essentially refers to frauds committed by bank employees in top echelon, that is top management level staff that are aimed largely at

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deceiving the shareholders and to a considerable extent, auditors and the regulatory authorities through deliberate presentation of false financial statement – the key device of perpetration (Jat, 1992). Like in other type of business endeavours, bank management frauds often take these two forms.

- a. Concealing inadequate business operation performances
- b. Concealing prohibited business activities

Banks that until the outset of the prudential guidelines presented over bloated fantastic profit positions in their dubious acts and return there on. These give shareholders and the government regulatory agencies the false impressions of their impressive performances and general health of bank until the enforcement of the guidelines revealed the emptiness and terminally ill nature of most banks (Nwankwo, 1991).

NDIC reports and other sources have revealed that top management bank officials have data times being behind several bank frauds in a related report, Ekechi (1998) states that "since NDIC commenced operations in 1995, it has prosecuted top class bank directors on offences contained in the failed banks". Investigations shows that the majority of the Nigerian banks were perpetuated by those occupying privileged positions and those employed to protect the banks finances, for instance, the former managing director of Equity Bank, Mr. Zoakarnachar was alleged to have used his position to steal 372.68 million. In the same vein, a former branch manager of Nigeria Universal Bank – Alhaji Jinadu Munai took undue advantage of his position to defraud bank the N12 million (Omachonu & Ndulor, 2008).

Employee Fraud: Employee Fraud refers to fraud committed by employees below management position. As distinguished from management fraud, employee's fraud does not involve alterations or misrepresentation of financial statements or information but the outright misappropriation of assets of the bank or the alternations of individual instruments such as cheques, drafts for the personal advantages. Frauds are the conversions of other assets the employers. Typical examples of employer to the fraudster's immediate benefits. Like their management counterpart, quite a number of employee's fraudulent act occurs after having gained a position of trust and responsibility. A considerable higher proportion of bank frauds are usually committed by employees in non-management, majority who are cashiers, clerks, accountant etc.

Causes of Bank Frauds

There are many identified causes of fraud in banks. They vary from institutional to economic, social, psychological, legal and even infrastructural causes. The immediate causative agents of frauds in general as provided by Ogbimika (2002) cited in Idogei, et al. (2017), are as follows.

- i. Availability of opportunities to perpetuate frauds and forgeries.
- ii. Human greed, avarice, instability.
- iii. Poverty and the widening gap between the rich and poor.
- iv. Prevailing misplaced social values, moral and spiritual decadence
- v. Increasing financial burden on individuals. Misapplied intelligence training adventures,
- vi. Job insecurity
- vii. Social misconceptions that banks money is nobody's money, property and therefore can be defrauded.
- viii. Societal expectations.

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- ix. Inadequate training or personnel.
- x. Unhealthy comparison and competition.
- xi. Revenge
- xii. Peer group pressure
- xiii. Leadership by hard example
- xiv. Poor/weak recruitment policies.
- xv. Over ambition/ frustrations of staff.
- xvi. Increasing and changing sophistication in technological
- xvii. Inadequate turning of manpower.
- xviii. Social indiscipline especially with money.
- xix. Lack of effective machinery that guarantee severe punishment for fraudsters and forgeries.
- xx. Possibility of identifying or topping a fraud may be very little.
- xxi. Poor/ weak management control, monitoring and supervision.
- xxii. Weak internal control system of the bank

Although there are many causes of Bank Frauds, hut weak internal control system stands as the major cause of frauds in banks, it is therefore, expedient that adequate efficient and effective internal control system be installed in every bank in order to reduce this disaster called fraud. Despite the numerous causes of bank frauds there exist some other factors that influences the risk of fraud within the bank and accordingly steps ought to be taken to minimize them. According to Izedonmi (2000), these factors include.

- a. Where authority is continually fails to implement internal control recommendations made by external auditor.
- b. Where there is a high rate of turnover in key accounting functions.
- c. Where the accounting system is inadequate and the books of accounts cannot be reconciled with the financial statements.
- d. Where the transactions occurring during the year are reversed after the year end.
- e. Where there are material transactions during and around the year and date.
- f. Where the bank is experiencing slovenly problems.
- g. Where it is difficult to obtain explanations from management and staff of the banks during the audit.
- h. Where it is difficult to obtain explanations from management and staff of the banks during the audit.
- i. Where documentation supporting transactions are generally non-existent. Other factors that could influence risk of fraud in banks according to Raji (1997) include;
- j. Experience: When too much confidence is reposed on a staff because of his apparent ability to work with minimum supervision due to his experience, it could degenerate into a situation that could breed an opportunity for committing fraud.
- k. Under Staffing: Most banks today, strife that strenuous efforts are made to cut down cost. This idea is however, over stretched that at times result to entrusting too many sensitive functions to a staff. No matter how good a staff is, carrying out his functions efficiently may not the easy to sustain. Understaffing will create opportunity for fraud, as there will be no room for any form of supervision.

It can be deduced from above factors that management needs to do a good job by installing an effective internal control system to reduce the exposure of the banks to frauds.

Effects of Frauds

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The activities of fraudsters have negative great effect of the affected banks. Some of the effects of fraud on banks according to the published report; provision of the NDIC (2016) include the following.

1. **The Distress Syndrome:** Bank Frauds tend to jeopardize the industrial growth of the Nation. Bank feuds have made some banks to wind up, while some are still battling the distress syndrome. Bank failure in Nigeria has gulped more than 40 billion so far from innocent. Depositors who end up losing their hard earned money and their confidence in these banks.
2. **Loss of Bank Frauds:** Frauds had caused hardship in banks, especially those whose liquidity state was already in doubt. As fraud cases in banks continue to rise, bank's losses in terms of money also rises.
3. **Bank Staff Involvement:** According to NDIC publication, about 1,914 banks staff of various ranks were involved in fraud between 199-1996. The obvious effect is possible termination of appointment, dismissal and suspension which would certainly affect their homes adversely.
4. **Illiquidity:** When banks experience fraud, some amount of money is being lost, this turn affect the banks liquidity position, this leading to their inability to meet their re-capitalization requirements.
5. **Bad Name:** According to the BBC News on Nigerian Bank Frauds, Nigeria has become synonymous with fraud as some of its citizens use the boom in the internet cafes to send spam mails, promising millions in exchange for the gullible recipient bank details. This has proved to us that fraud has become an unfortunate staple in Nigeria's International reputation, thus, giving us a bad name. from the above effects, it can be concluded that frauds is really a destructive force on a mission to spoil the name of financial institutions, render so many employers of labour jobless, close down banks and erase the confidence of the people in the country's banks. This condition is very bad and unfortunate. Hence, efficient internal control system must be filling effected. Opinion with regard to the best interest of the organization.

Consequently, executives may be seen as using organizations to get as much as they can at the expense of the owners. Agency theory explains the application of controls as being primarily based on economic cost benefit analysis where controls are installed order to reduce information asymmetries between principals and owners. Additionally, the theory has been used to explain demands for monitoring controls such as financial statement audit, external directors on boards and committees, internal audit and compensation schemes (Arwingeb, 2013). Thus, internal controls, financial audits are among the many mechanisms used in business to address agency problem (Jensen & Payne, 2003).

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