



Fraud prevention in the Nigerian banking sector: An assessment of internal control system measures

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Abstract

This study assessed the Internal Control System as a fraud-prevention mechanism in the Nigerian banking sector. The goal was to determine whether this accomplished the intended result, particularly in famous Nigerian banks. To that goal, the study purposefully collected data from five Nigerian commercial banks. The information was gathered from bank audited and publicized financial statements, and it was examined using the Product Moment Correlation Coefficient and regression analysis. According to the data, the Internal Control System has considerably avoided and reduced fraud in Nigerian banks. That poor corporate governance was to blame for the proper design of the Internal Control System, and that the Internal Control System has resulted in a rise in the corporate performance of Nigerian banks. Based on the findings, it was recommended that the management of each bank create and implement a standard Internal Control System that is strong enough to withstand the wiles of fraud in order to promote operational continuity and to ensure the banks' liquidity or solvency and going concern concept.

Keywords: internal control system, banks, fraud, corporate governance, corporate performance

Introduction

Banking institutions have a vital role in the nation's financial system and are critical agents in the economic development process. Banks boost the amount of national savings and investments, and thus national GDP, by acting as intermediaries between surplus and deficit spending units. Banks produce money by providing credits, influencing the amount of money supply, which is an important factor in the growth of national revenue since it influences the degree of economic activity in the country (Etuk, 2011) ^[9].

Banks play an important role in the payment system since they facilitate economic transactions between various national and international economic units, hence encouraging and promoting trade, commercial, and industry. The banking sector is extremely important in the development of any economy (Adeyemo, 2012) ^[2]. Banks are the primary depositories of public monetary deposits in most economies, the nerve center of the payment system, the vessel endowed with the authority to create money and allocate financial resources, and the conduit through which monetary and credit policies are enacted (Idolor, 2010 and Akindele, 2011) ^[12, 3]. To a considerable part, the success of monetary policy is determined by the health of the banking institutions through which the policies are implemented (Adeyemo, 2012) ^[2]. Whatever issues impede the banking sector's normal operation will invariably have a multiplier effect on the rest of the economy. This is one of the reasons why it is critical to rapidly identify and address any factors that may impede the smooth operation of the banking sector. However, in order for banks to function successfully and contribute meaningfully to a country's growth, the industry must be stable, secure, and bound. And in order for these conditions to be met, there must be a good accounting system, which is enabled by an Internal Control System. Given the economic expansion in the size and complexity of firms, proper management of current business understandings is not possible unless they have an effective system of internal control.

An effective internal control system is a vital component of bank management and the foundation for a financial organization's safe and secure functioning (Andrew, 2008). A good internal control system can help to ensure that a banking organization's goals and objectives are accomplished, that long-term profitability targets are met, and that financial and managerial reporting is credible. A system like this can also serve to guarantee that the bank complies with laws and regulations, as well as policies, strategies, internal rules, and processes, and reduce the risk of unanticipated losses or reputational harm.

The importance of internal control systems in organizations, particularly banks, cannot be overstated, given that the banking sector, which plays a critical role in a country's economic development, is currently characterized by macroeconomic instability, slow growth in real economic activities, corruption, and the risk of fraud.

An internal has two key components. Internal control systems include prevent controls (which prevent errors) and detect controls (these control that detect error and fraud which have occurred).

As a result, an internal control system is a necessary prerequisite for the efficient and effective administration of any business, including banks, which is the primary topic of this study.

Statement of the Problem

Internal control systems are regarded as crucial in accounting systems since they improve the efficacy and efficiency of an enterprise's management.

An effective and efficient internal control system assures that all recorded transactions are actual, properly priced, recorded, timely, correctly categorised, summarized, and posted. However, whether or not an internal control system has aided management in having a bound accounting system, particularly in the areas of "prevent controls and defect control" that most firms face, remains contested and controversial.

As a result, the purpose of this study is to validate the belief that an effective and efficient internal control system is the best control measure for preventing and detecting fraud, particularly in the banking sector.

In light of the foregoing, the following research questions were posed.

- i Has the internal control system, as a preventive measure, greatly reduced fraud in the Nigerian banking sector?
- ii Is poor corporate governance to blame for the usage of internal control systems in the Nigerian banking sector?
- iv What impact does the internal control system have on the corporate performance of the Nigerian banking sector?

The following hypotheses were tested during the course of this research:

1. Internal control systems have not considerably reduced fraud in the Nigerian banking sector as a preventive strategy.
2. Poor corporate governance is not to blame for the usage of internal control systems in the Nigerian banking sector.

Internal control systems have a substantial impact on the corporate performance of the Nigerian banking sector.

Literature Review

The Nigerian banking industry, which is regulated by the Central Bank of Nigeria, consists of deposit money banks known as commercial banks, development finance institutions, and other financial institutions such as microfinance banks, finance companies, bureau de changes, discount houses, and primary mortgage institutions. By the 1980s, the licensing of new banks in Nigeria had been liberalized, and most banks were undercapitalized, with insufficient internal controls in place. Most of these failed, according to CBN (2005), as there were 90 licensed insured banks, 282 licensed main mortgage institutions, and six Development Finance Institutions by the end of 2002.

The CBN issued a circular in 2004 requiring all commercial banks in the country to enhance their capital base to a minimum of N25 billion. This resulted in major mergers and acquisitions in the banking industry. Banks are projected to perform better and have a beneficial impact on the real sector as their capital base improves. According to Achebe (2008) ^[1], the Nigerian banking industry gained stronger in 2007, as evidenced by several performance measures. With significant credit flow to the core private sector, the industry demonstrated its ability to finance real sector activities, posing a significant challenge to the internal control system. Although they had beneficial impacts such as restoring confidence in the banking sector and lowering interest rates, the death of credit to the actual sector of the economy persisted.

Furthermore, market competitiveness and the rising use of Information and Communication Technology (ICT) have resulted in the development of new ICT-based banking products. This has resulted in a move away from cash-based transactions, which has enhanced the effectiveness of fraud detection.

Internal Control Principles

The current banking system's structure, as well as the high expectations of investors and society at large, have necessitated a more stringent internal control mechanism.

Internal control has been characterized in numerous ways. According to Princeton (2008), internal control is a process effected by an organization's structure, work and authority flows people, and management information system, designed to assist the organization in accomplishing a specific goal or objective. From the definition, the goal of any internal control should be directed towards the attainment of the organization's objective.

An effective internal control system included a clear description and separation of roles for different employers and groups inside a company. The goal of separating the roles is to protect against fraud, waste, abuse and resource mismanagement. Internal control that is effective helps to ensure the correctness of reporting to management and the various monitoring bodies (in the case of banks). Internal control, according to Asuquo (2005), consists of internal checks, internal audit, financial controls, and other types of controls such as budgetary and physical control. Internal control is defined by the COSO framework as a process carried out by an entity's board of directors, management, and other personnel to provide reasonable assurance regarding the achievement of objectives in the following categories: effectiveness and efficiency of operation, reliability of financial reporting, and compliance with applicable laws and regulations. Internal controls are policies, procedures, practices, and organizational structures put in place to provide reasonable assurance that an

organization's business objectives will be met and that undesirable right events will be prevented, detected, and corrected, based on either compliance or management-initiated concern (Awe, 2005). Internal control, according to these definitions, is an organization's plan and all of the coordinated methods and measures implemented within it to safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency, and encourage adherence to prescribed managerial policies. Internal control objectives are aimed at assuring conformity to managerial policies and, in general, attaining organizational goals. Internal Control Classification ICAN (2006) ^[11] classified control into three major categories. Preventive controls: These are controls that predict possible problems and make modifications before they occur. They also keep an error, omission, or malevolent conduct from happening. Preventive controls involve employing well-designed documents to prevent errors and setting appropriate procedures for transaction authorization. Employ only qualified individuals. Detective controls are intended to detect and report the occurrence of an omission, error, or malicious act. Calculation duplicate checking is an example of a detective control. Periodic performance reporting with problem messages displayed on tape labels Hash totals are used to balance cheques and post-due account reports. Corrective controls: These controls serve to reduce the impact of a threat, identify the source of an issue, and repair errors caused by the problem. They also rectify faults detected by detective controls and adjust the processing system(s) to reduce the occurrence of the problem in the future. Examples of corrective measures Contingency planning, backup procedures, and rerun procedures are examples of controls.

An effective internal control system is an essential component of bank management and the foundation for the safe and sound operation of banking institutions. A good internal control system can help to ensure that a banking organization's goals and objectives are accomplished, that long-term profitability targets are met, and that financial and managerial reporting is credible. A system like this can also help to guarantee that the bank complies with laws and regulations, as well as policies, strategies, internal rules, and processes, lowering the risk of unanticipated losses or reputational harm.

The Fraud Concept

Scholars and professionals have variously characterized fraud in the literature. According to Idowu (2009), fraud is the intentional misrepresentation, concealment, or omission of the truth for the purpose of deception/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, misuse, or harm the bank's asset.

According to the ICAN study pack (2006), fraud includes both the use of deception to acquire an illegal financial advantage and intentional fabrication of financial statements by one or more individuals from management, staff, or third parties. Fraud, in its various manifestations, diminishes a company's assets while increasing its liability. In the case of banks, this may result in the loss of potential clients or a crisis of confidence among the banking public, ultimately leading to another failed bank situation.

According to the definition given above, fraud is defined as the intentional misrepresentation of financial facts by one or more individuals among management staff or third parties. From any perspective, fraud is simply a deceptive and dishonest conduct that entails unlawfully removing a property from its owner without his/her knowledge, permission, or consent, or intentionally or negligently misstating a circumstance.

This issue of fraud is a common occurrence in national life. It is common practice in both the public and private sectors. Fraud in the banking industry is on the rise. Every day, businesses fail as a result of fraudsters' actions.

Fraud Classification

Attempts will be made within the scope of this study to critically evaluate the two primary strategies of deception. Fraud is divided into two types:

1. Management deception
2. Employee deception

Management Deception

Management fraud, according to Fakunle (2006) ^[10], frequently involves the manipulation of records and accounts, typically by the enterprise's senior officer with a view to benefit in an indirect way. As an example, consider getting financing under false pretenses or hiding a substantial materially deteriorating the company's true status, i.e. window dressing

Management fraud is typically committed by an organization's management personnel, which includes directors, general managers, and managing directors, among others. Management fraud victims include investors and creditors, and the tool used to commit the crime is a financial statement.

The goal of management fraud is usually to entice new shareholders to come and invest in the firm. It is also maintained so that the firm will be in a better position to get bank loans because a good statement will display a healthy look, making it a strong collateral security.

Employee Deception

This is often referred to as non-management fraud. These are deceptions committed by workers of a company. It frequently involves some kind of fabrication, such as fake information. Paper work, lying, abusing authority, or breaking an employer's standards, stealing company cash frequently in the form of cash or other assets It consists of three stages: the fraudulent conduct, the transfer of money or property to the fraudsters, and the cover-up.

Employee fraud is more likely to occur when internal controls are lax. According to Awe (2005) [7], other examples of employee fraud include fraudulent payment of supplies and wage fraud (payroll fraud).

It is vital to remember that all of these types of employee fraud are committed in order for the offenders to benefit unduly from all of the irregularities committed, as defined by the definition of fraud.

The Roots of Bank Fraud

There are numerous documented causes of bank fraud. They range from institutional to economic, social, psychological, legal, and even infrastructure-related reasons. According to Ogbunka (2002), the following are the immediate causative agents of frauds in general: the availability of opportunities to perpetrate frauds and forgeries, human greed, avarice, instability, increasing incidence of unemployment, job insecurity, increasing financial burden on individuals, societal expectations, inadequate training of man power, risk on the fraudsters may be low or none, poor/weak management control, monitoring and supervision, and weak internal control s.

True, there are other causes of bank fraud, but a weak internal control system is the leading source of bank fraud. It is consequently necessary for every bank to create an adequate, efficient, and effective internal control system in order to reduce the tragedy known as fraud.

Fraud's Impact on Nigerian Banks

Fraud is one of the most dangerous hazards that banks face. The magnitude of bank fraud in Nigeria can be estimated based on its value, volume, and actual loss. A significant amount of bank frauds are never reported to the relevant authorities; instead, they are repressed, either due to the personalities involved or due to fear about the terrible image effect that disclosure would have.

If information is disclosed to the banking public, this could have serious consequences. Customers of banks may lose faith in them and this could impede the bank's growth in particular.

It also has a negative impact on the asset quality of banks. When accompanied by insider loan abuses, the problem becomes more hazardous. Indeed, the first generation of NDIC-liquidated institutions was mostly the result of frauds committed through insider loan abuses. If this issue is not addressed properly, it may cause hardship and bank collapses.

Fraud can raise a bank's operational costs because to the additional expense of establishing the appropriate machinery for asset prevention, detection, and protection. Furthermore, paying important time to protecting company funds from fraudulent guys diverts management's attention. Overall, this inefficient use of resources diminishes outputs and leads to poor profits, which might stifle the bank's growth.

Fraud causes money to be lost, whether it belongs to the bank or the clients. Such losses may be absorbed by profits for the impacted trading period, reducing the amount of profit that would otherwise be available for distribution to shareholders.

Losses from fraud that are incorporated into the bank's equity capital harm the bank's financial health and limit its ability to make loans and advances. lucrative business operations In extreme situations, widespread and large-scale fraud could lead to the failure of a bank.

Methodology

The authors purposefully chose five banks for survey in order to conduct an empirical examination of the significance of internal control systems as a preventive measure of fraud in the banking sector (i.e Access bank, Diamond bank, First bank of Nigeria, United bank of Africa and Wema Bank). Aside from the survey study, which was conducted using primary data (questionnaires), the authors went on to inspect and evaluate the books of these chosen banks Data (secondary) were collected from the bank's financial records for studies, using financial data spanning five years, from 2006 to 2010. The study, however, relied extensively on secondary data from academic publications, textbooks, periodicals, newspapers, annual reports of firms, and internal sources. Furthermore, it was more objective to analyze data from the company's published accounts to exclude personal opinion, which would help to ensure the validity and trustworthiness of empirical facts and subsequent analysis.

The formulated hypotheses were tested with the statistical techniques of Person Product Moment Correlation coefficient and simple linear regression a formula of the type

$$Y=a+bx+$$

Where y is the dependent variable (fraud, poor corporate governance, and poor business performance). an is the intercept parameter.

b=parameter for slope

x = unrelated variable (internal control system)

=term of stochastic error

Discussion and Result

The first hypothesis examines the impact of internal control systems on fraud in the Nigerian banking sector. The outcomes are shown in tables 1, 2, and 3. revealed that the computed t-statistics for the internal control system parameter are more than data tabulated at the level of significance Internal control was also indicated by the regression equation.

Every drop in fraud in the Nigerian banking sector was accounted for by the system. The coefficient of determination indicates that 92 percent of The variety in fraud reduction is caused by the variation in the internal control system. The remaining 8% unexplained variable is primarily attributable to variation in other variables outside the regression model that is not otherwise included in the stochastic error component. At The, the association between fraud and internal control is highly favorable and statistically significant. In terms of overall goodness of fit, the overall regression model is statistically significant. As a result of this, The study accepts the substitution hypothesis, which means that the internal control system, as a preventive measure, has significantly reduced fraud in the Nigerian banking sector.

Table 1: Model Summary

Model	R	R Square	Adjusted R Square
1	0.526	0.854	0.856

- a. Predictor: (Constant) internal control system
- b. Department variable: Fraud

Table 2: Coefficients

Model	Under standard coefficient	Standard coefficient	
	Beta	T	Sig
(constant)	34476.18	0.546	0.001
Internal control	43123.66		
Fraud	7.352	0.959	0.002
	1.362	5.653	

Dependent variable: Fraud

Table 3: ANOVA

	Model	Sum square	of	Df	Mean Square	F	Sig
1	Regression	31191.194		1	20090.194	47.024	0.000
	Residual	8715.339		23	427.232		
	Total	18.805.422		24			

- a. Predictor: (Constant) internal control system
- b. Dependent variable: Fraud

Tables 4, 5, and 6 present the second possibility. The outcome assessed whether poor corporate governance was to blame for the mandatory design of internal control systems in the Nigerian banking sector. The outcome revealed that, at the 0.05 level of significance, estimated t - statistics was bigger than tabulated t= statistics. The coefficient of determination was 0.896, implying that weak governance was responsible for 89 percent of the variation.

Internal control system variation The remaining 11% unexplained variation is generated by variables outside the regression model that are not included in the stochastic error term. The association between poor corporate governance and an ineffective internal control system is robust, positive, and statistically significant at the 0.05 alpha level (. Furthermore, the regression model has statistical significance in terms of overall goodness of fit. As a result, the other hypothesis was accepted. This means that the usage of internal control systems in the Nigerian banking sector was caused by poor corporate governance.

Table 4: Model Summary

Model	R	R Square	Adjusted R Square
2	0.836	0.785	0.758

- a. Predictor: (Constant) internal control system
- b. Dependent variable: Bad Corporate Governance

Table 5: Coefficients

Model	Under standard coefficient	Standard coefficient	
	Beta	T	Sig
(constant)	292393.5	1.384	0.003
Internal control Bad	242212.0		
Corporate Governance	6.284	0.858	0.000
	1.332	6.975	

Dependent variable: Bad Corporate Governance

Table 6: ANOVA

2	Model	Sum of Square	Df	Mean Square	F	Sig
	Regression	221866.271	1	110955.182	25.706	0.000
	Residual	88163.622	23	3427.372		
	Total	210229.693	24			

- a. Predictor: (Constant) internal control system
- b. Dependent variable: Bad Corporate Governance

Hypothesis three, as shown in tables 7, 8, and 9, demonstrated the effect of the internal control system on corporate performance. At the 0.05 threshold of significance, the computed was greater than the tabulated t-statistics. The coefficient of determination indicated that internal control system variation accounted for 66% of the variation in corporate governance. The remaining 34% unexplained variation is generated by variables outside the regression model that are part of the stochastic error team. At the alpha level, the association between corporate performance and internal control system is strong, positive, and statistically significant. Furthermore, the regression model's overall goodness of fit is statistically significant. As a result, the other hypothesis was accepted. This implies that the internal control system has a substantial impact on the corporate performance of the Nigerian banking sector.

Table 7: Model Summary

Model	R	R Square	Adjusted R Square
3	0.923	0.769	0.746

1. Predictor: (Constant) internal control system
2. Dependent variable: Corporate Performance

Table 8: Coefficients

Model	Under standard coefficient	Standard coefficient	Sig		
	Beta	std Error	Beta T		
(constant) Internal control	312356.4	172112.2	1.621	0.001	
Corporate Performance	7.264	1.352	0.923	6.534	0.002

Dependent variable: Corporate Performance

Table 9: ANOVA

3	Model	Sum Square	of	Df	Mean Square	F	Sig
	Regression	23154.342		1	234142.130	23.540	0.000
	Residual	22822.561		23	418.112		
	Total	34663.824		24			

- a. **Predictor:** (Constant) internal control system
- Dependent variable: Corporate Performance

Recommendations and Conclusion

The research assessed the effectiveness of internal control systems in preventing fraud in the Nigerian banking sector. The study was prompted by the fact that bank fraud is now a global phenomenon, and that fraud in general causes immense pain for bank owners, clients, and family members, as most bank failures are related with large-scale frauds. The management is primarily responsible for the prevention and detection of frauds through the construction of an effective and efficient internal control system.

According to the study, internal control architecture has gone a long way toward reducing the threat of fraud in the Nigerian banking sector, resulting in an increase in corporate performance in the banking sector. To summarize, the importance of every organization's internal control department, particularly banks, cannot be overstated.

As a result, the study recommended that every bank's management build and implement a standard internal control system that is robust enough to withstand the machinations of fraud in order to maintain operational continuity and ensure the banks' liquidity, solvency, and continuing concern concept.

Finally, internal control procedures and strategies should be constantly improved. Only excellent internal controls can ensure the continued existence and profitability of Nigerian banks.

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