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INTERNAL CONTROL AND FINANCIAL FRAUD IN THE NIGERIAN BANKING INDUSTRY

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Abstract
With the susceptibility of the banking industry to the liquid nature of its assets, this study was carried out to examine the effect of internal control on financial fraud in the Nigerian banking industry. The study is framed theoretically using the pentagon fraud theory. The exploratory research design was employed for this study. Secondary source of data was used and data on the independent and dependent variables were obtained from available data which is the NDIC 2019 Report. The data gathered were analyzed using the Multiple regression model. was used in analyzing the effect of the independent variables on the dependent variable. The result shows that staff control has a positive effect on fraud prevention in the banking industry in Nigeria. It is concluded from the study that staff control does not have a significant effect on fraud in the banking industry in Nigeria. This study recommends that staff controls be put in place to ensure that the right human resources are attracted and retained for the job in order to prevent financial fraud in the banking industry in Nigeria.

Keywords: Fraud, Internal Control, Liquid Asset, Staff Control

1.0 Introduction

Internal control system is the whole system of control that is designed by management to safeguard the assets of the organization and ensure that the records are accurately maintained. It is made up of various types such as segregation of duties, authorization control (Adelana & Toba, 2018). Various studies have been carried out on the effect of internal control on fraud detection and prevention. Several studies have been carried out to examine internal control in its entirety on fraud prevention and detection (Abiola & Oyewole, 2013; Ozigbo, 2015; Nugraha & Bayunitri, 2020). A review of the Nigerian Deposit Insurance Commission (NDIC) report of 2019 shows that between 2015 and 2019, the number of reported fraud cases in the banking industry in Nigeria tripled. Joloko and Audu (2019) opined that fraud in any form transcends to loss for any organization in which it occurs. For effective, safe and profitable business operations, financial institutions around the world have designed measures commonly called the Internal Control Systems. Nwaobia, Omotayo and Ajibade (2021) posit that internal control system is generally set-up to prevent and detect fraud. However, Udeh and Ugwu (2018) asserted that despite the existence of internal control system, fraud occurrence has not been abetted in the banking industry in Nigeria. Fraud is prevalent in most segments of the Nigerian economy but it is more glaring in the banks, probably because of the liquid nature of the banks' assets (i.e. cash) which can be easily carted away (Nuhu, Salishu & Kofarnaisa, 2017). Banks in Nigeria are licensed to carry out banking business after meeting the stringent requirements of law. In the Nigeria Banking and other financial Act of 2020 it can be deduced that an institution is a bank if it has a license to be so called and performs some basic functions such as providing deposit facilities for the general public, permitting money to be withdrawn or transferred from one account to another and lending the surplus of deposited money to customers who wish to borrow (BOFIA, 2020).

However, Arogundade, Ohwo and Audu (2020) stated that the most important resource in the organization is man who is the coordinator of all other resources. Further to this, in its 1989 – 1997 report, the Nigeria Deposit Insurance Corporation (NDIC) classified perpetrators of bank fraud into two main groups: bank employees and non-employees. The focus of this study is on bank employees since these are the people that could comit internal fraud. In line with this position, the main objective of this study is assess the effect of internal control on fraud prevention in the banking industry in Nigeria. In this regard, there seems to be paucity of studies in this direction as most studies as shown earlier viewed internal audit in in its totality. There seems to exist a knowledge gap in the area of examining the impact of staffing control and fraud in the banking industry of Nigeria. Hence, this study is designed to fill that knowledge gap by examining staffing control on fraud in the banking industry of Nigeria. The remaining part of this study covers the review of literature which covers conceptual review, theoretical review and empirical review. The methodology employed in this study is also shown and thereafter the analysis of data, which is followed by the discussion of findings in the light of existing literature, conclusion and recommendations.

2.0 Literature Review

The literature review for this study is carried out from three aspects which cuts across the conceptual review, theoretical review and empirical review as shown below.

2.1 Conceptual Review

Internal Control can be described as internal procedures set up by management to safeguard the assets of the organization and that proper records are kept (Kontogeoris, 2010). Internal control system can also be defined as a system of control, which could be financial or otherwise that is setup by management to make sure that the activities of the firm is carried out without irregular occurrence, maintain compliance with policies, safeguard assets and ensure the completeness and accuracy of records. The general rule is that internal controls must provide a reasonable assurance (rather than a perfect assurance) that they will achieve their objectives. Thus, they must reflect a balance between the benefits of reducing risk exposures and the costs of implementing the controls. This means that internal control processes must be designed

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within the context of management's enterprise risk management (ERM) system (Hopwood, Leiner & Young, 2012).

Internal control is made up of physical control, authorization control, personnel control, arithmetical control, management control, organization structure control, segregation of duties control and staffing control. For the purpose of this study, staffing control is the construct to represent internal control. Staffing control can be described as the type of control that makes sure that the right employees are employed for the right job.

Fraud on the other hand, can be defined as an intentional misrepresentation of the record or manipulations calculated at cheating the other party (Joloko & Audu, 2019). Furthermore, Coenen (2008) described fraud as an intentional disregard for the system and a deliberate attempt to breach the system for personal gain. According to Blacks' Law Dictionary (1990) fraud is defined as an intentional perversion of truth for the purpose of inducing another relying upon it to part with some valuable thing belonging to him or to surrender a legal right. Fraud in the banking industry has been broadly classified into two which are fraud carried out by employees and fraud carried out by outsiders (Abiola & Oyewole, 2013).

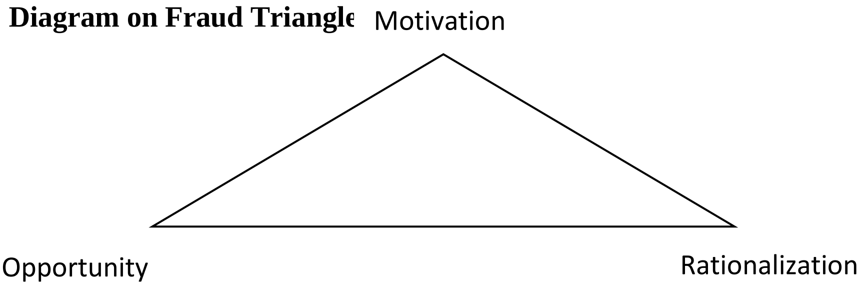
2.2 Theoretical Review

This study is hinged on the fraud triangle and the fraud pentagon theories. The fraud triangle theory is pivotal role it played in the development of theories on fraud as it laid the groundwork for theories on fraud. The fraud pentagon theory on the other hand, is a current modification of the fraud triangle theory.

The Fraud Triangle Theory

Fraud triangle theory was propounded by Donald Cressy in the year 1950. The theory identifies three main reasons why individuals commit fraud. The reasons pointed out from the theory are motivation/ pressure, opportunity and rationalization.

Figure 1: Diagram on Fraud Triangle



Ardi, Sulistyo and Roziq (2019) highlighted some weaknesses with the fraud triangle theory. These weaknesses range from not clearly showing the scale of the probable level of fraud from the various causes of fraud as prescribed by the theory, omission of the ability reason to actually perpetrate the fraud, not identifying the pressure reason for fraud into financial and non-financial forms.

In spite of the weaknesses, Siska, Zainal and Tatik (2020) posited that the fraud triangle theory plays a pivotal role in the development of theories on fraud and that all other theories on fraud are built or a modification of it.

In this study, the fraud triangle theory is used to show relationship between staff fraud, liquid asset and fraud. Based on the theory, the higher the liquid assets maintained, the more staff fraud might prevail as they are motivated and have a reason to easily take liquid assets illegally (fraudulently).

Fraud Pentagon Theory

Siska, Zainal and Tatik (2019) noted that this theory is the latest modification of the fraud triangle theory. The theory was developed by Vousinas in 2019. The theory identified five factors that could lead individuals to perpetrate fraud. These factors stem from stimulus, capability, opportunity, rationalization and ego. It is given an acronym 'SCORE model". Due to the five factors identified, it is called 'pentagon'.

Kassem and Higson (2012) argued that all other theories (fraud diamond theory, MICE model and the new fraud triangle model), on fraud are just a modification of fraud theory. And as such does not really provide anything new.

However, the fraud pentagon theory clearly breaks down the three main factors in the fraud triangle fraud and also cuts across all other fraud theories (Ardi, Sulistyo & Roziq, 2019).

The fraud pentagon theory shows the various reasons individuals carry out fraud. Based on this, the liquid asset which is seen as very susceptible to fraud and staff fraud level is examined in this study and as such, members of staff in the banking industry are opportune to work with liquid assets and possess the capability to illegally obtain such assets as liquid assets are easy to steal. Also, the employees of banks generally have an ego or class that have been created for them. Based on these, the fraud pentagon theory seems to be suitable for this study.

2.3 Empirical Review

Various studies have been carried out on internal control relationship with fraud. For instance, Abiola and Oyewole (2013) assessed the effect of internal control system on fraud detection in selected banks in Nigeria using a mixed method. They discovered that employee training has an effect on fraud detection.

Ozigbo (2015) assessed the relationship between internal control and fraud prevention among Nigerian businesses. Field survey was employed and primary data was gathered. It was revealed from the study that internal control has a significant relationship with fraud prevention.

In Kenya, Kabue and Aduda (2017) examined the effect of internal controls on fraud detection and prevention. The field survey research design was used and primary data was collected through the use of a research questionnaire. They found out that reconciliation control has a significant effect on the level of fraud prevention and detection.

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Nuhu, Salisu and Kofarnasia (2017) assessed the effect of internal accounting control, management features, audit committee effect on curbing fraud in Nigeria using the survey method.

The study showed that internal accounting control does not contribute to curbing of fraud however, management features contributes in the elimination of fraud.

In addition, Adelana and Toba (2018) examined the effect of internal control on fraud detection and prevention in Ondo, Nigeria using survey method. They revealed that system authorization has a significant relationship with fraud prevention and control.

Nugraha and Bayunitri (2020) examined the effect of internal control on fraud prevention in banks situated in Cimahi City located in Indonesia using the exploratory research design which involved the use of primary data which was collected. The result of the study showed that internal control has a significant effect on fraud prevention.

Nwaobia, Omotayo and Ajibade (2021) assessed the association between internal auditor's personality and fraud detection of banks listed in Nigeria. They employed a cross-sectional survey design and used primary data collected through a questionnaire. The study revealed that internal control contributes to the curbing of fraud.

Ugwu and Ochuba (2021) examined internal control effect on fraud in listed deposit money banks in Enugu, Nigeria using survey method. They found out that internal control contributes to the curbing of fraud.

From the extent of work done so far, there is a knowledge gap on how staff control impacts on financial fraud. Hence this study intends to fill this gap and in doing so, the following hypothesis is stated:

H_0: Internal control has no significant effect on financial fraud prevention in the banking industry of Nigeria.

3.0 Methodology

The quantitative research method is employed for this study while the exploratory research design is used which implies that events and records that have happened in the past are examined in this study. The secondary source of data used for this study was sourced from the Nigerian Deposit Insurance Commission annual report of 2019. The data spans across five years which ranges from 2015 to 2019. This period was chosen as it relates to the first tenure of the Buhari led administration in Nigeria which had as one of its core objectives, the curbing of corruption and fraudulent practice in Nigeria. The study is focused on the banking industry in Nigeria. The multiple regression model is used in this study to measure the effect of the independent variable (internal control) on the dependent variable (fraud). The model for this study are as depicted below:

$FR = \alpha + \beta_1 SC + \beta_2 DR + e$

Where

FR = Financial Fraud (Dependent variable)

b_1SC = staff control (independent variable)

b_2DR = Deposit ratio (independent variable).

Table 1. Measurement of Variables

S/N	Variable	Unit of Measurement	Source
1.	b_1SC = staff control (independent variable)	No of staff fraud reported	NDIC 2019 Report
2.	b_2DR = Deposit ratio (independent variable).	Total deposit divided by total asset expressed as a percentage as reported	NDIC 2019 Report
3.	FR = Financial Fraud (Dependent variable)	Number of financial fraud cases reported	NDIC 2019 Report

Source: Author's Compilation (2022)

3.1 Data Presentation and Analysis

The data gathered and the result of the data analysis is presented below:

Table 2. Presentation of Data

Year	Staff Fraud	Average Deposit to Asset Ratio	Fraud
2015	425	48.63	12,279
2016	231	43.96	16,751
2017	320	45.56	26,182
2018	899	51.87	37,817
2019	835	45.45	52,754

Source: NDIC 2019 Report

Table 2 shows that within the period, staff fraud was the lowest in year 2016 with a total of 231 cases reported. While year 2018 was the highest number of staff fraud cases reported with a total of 899 cases. Similarly, the deposit ratio is at the peak in year 2018 at 51.87% while it's at the lowest in year 2016 at 43.96%. Finally, it reveals that the number of fraud cases reported increased progressively within the time frame covered by this study with the lowest being in 2015 with a total number of 12,279 cases and the highest being in 2019 with a total of 52,754 cases.

Test of Hypothesis

H_0: Internal control has no significant effect on financial fraud prevention in the banking industry of Nigeria.

Table 3. Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.968[a]	.938	.876	5793.39144

a. Predictors: (Constant), Average Liquidity Ratio, Staff Fraud

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Table 3 shows that the independent variables explain the dependent variable by 87.6%. This confirms that the independent variables explain the dependent variable to a large extent. The study result further shows that there is a close relationship between internal control and fraud prevention in the banking industry in Nigeria.

Table 4: ANOVA[a]

Model	Sum of Squares	Df	Mean Square	F	Sig.
Regression	1012313584.449	2	506156792.225	15.081	.062[b]
Residual	67126768.751	2	33563384.375		
Total	1079440353.200	4			

a. Dependent Variable: Fraud
b. Predictors: (Constant), Average Liquidity Ratio, Staff Fraud

Table 4 reveals the computed p-value as 0.062. which higher is than the set p-value of 0.05. This means that the alternate hypothesis is rejected and the null hypothesis which states that 'internal control system has no significant effect on fraud prevention in the banking industry of Nigeria' is retained.

Table 5: Coefficients[a]

	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta		
(Constant)	151587.707	50791.893		2.984	.096
Staff Fraud	65.438	11.975	1.216	5.465	.032
Average Liquidity Ratio	-3352.836	1155.686	-.646	-2.901	.101

a. Dependent Variable: Fraud

Table 5 shows the coefficient value of the independent variables in the study. Staff control has a positive relationship with fraud prevention while the level of liquidity has an inverse relationship with fraud. This means that the more the number of staff fraud, the more the probability of fraud prevention. On the other hand, the higher the liquidity asset level in the banks, the lower the level of fraud in the banking industry in Nigeria.

4.1 Discussion of Findings

The result from the study shows that staff fraud contributes positively to fraud prevention in the banking industry however, it is not significant as table 2 shows a computed p-value of 0.062 which is greater than the set p-value of 0.05. This is similar to the position of (Nuhu, Salisu & Kofarnasia, 2017) who also agreed that internal control does not have a significant effect on fraud prevention. In the light of this, it suggests that even though staff fraud occurs in the banking sector, is not significant when compared to the numerous sources of fraud carried out in the banking sector. This can therefore mean that the significant portion of fraud that take place is not staff fraud but fraud that takes place outside the organization. When examining the varying results, it can be further deduced that internal control has a significant effect on fraud prevention and detection. A reason for the variance in results is the difference in the proxy used to measure internal control. Hence, could be a reason for the difference in results. The result from this study shows that staff fraud does not contribute significantly to fraud in the banking industry. However, the result suggests that other factors such as internet related fraud among others are the major drivers of fraud.

This study further confirms the theoretical position of the fraud triangle theory and fraud pentagon theory which provides reasons for frauds. In this study liquid asset held by the bank and staff fraud from the regression result shows that the liquid asset held by banks actually explain the level of fraud carried out in the banking industry. However, there are other factors that drive fraud.

5.0 Conclusion and Recommendations

The study is designed to examine the effect of internal control on fraud prevention in the banking industry of Nigeria. The result of the study shows that internal control largely explains the fraud prevention in the Nigerian banking industry. However, it is concluded from the study that internal control has no significant effect on fraud prevention in the banking industry of Nigeria. Based on the findings from the study, it is recommended that:

i. Management of banks need to ensure that controls are put in place to ensure that the right quality of employees are recruited into the banking operations and
ii. Management of banks need to ensure that electronic media used to facilitate the movement of funds are adequately secured against fraud by adding varying layers of controls in order to prevent electronic fraud.

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