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Fraud and its Effect on the Stability of Financial Institutions in Nigeria

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Abstract: *The effect of fraud was examined on the stability of financial institution in Nigeria for the last ten (10) years. IFR, PBP, FRL & MOL was used as representation of fraud while bank stability(BSTA) was used to represent financial institution stability. Seven banks resident in Abraka Ethiope East was used as the sample of the study. Primary data was obtained through questionnaire why secondary data was obtain from financial statement of the banks from 2013 to 2022. The coded response coupled with the financial data of banks understudied was analysed with the aid of statistical package for social sciences (SPSS). The results showed that inappropriate financial reporting, poor book keeping practices, fraudulent loans & money laundering has a negative and statistical significant influence on stability of financial institution in Nigeria. Consequence to the findings, the study recommend that measures (internal &external) should be put in place in the institution to curb fraud from its conception in order to reduce if not eliminate fraud in the financial service sector. Likewise, penalty for fraudulent activities should be spelt out clearly and publicized as this would discourage fraudulent tendencies.*

Introduction

The financial sector is one of the most critical sectors in the economy with influence on the direction and level of economic growth. By creating wealth and transferring it from deficit to surplus units through the extension of loans and advances, financial institutions, specifically banks, perform the function of financial intermediation (Aroghene & Ikeora, 2022). In the present day, the reliability and survival of these credible tasks of Nigerian banks have been deteriorated in view of incessant frauds and accounting indignities.

Fraud is the wrongful or criminal deception projected to result in financial or individual gain. It is simply false representation. 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. It can take many forms including making false insurance claims, cooking the books, pump and dump schemes and identity theft leading to authorized purchases. Olufidipe (1994) defined fraud as deceit or trick deliberately practiced in order to gain some advantages dishonestly. Incessant scams in financial firms (banks) result in stakeholder's loss of reliance and confidence in the industry. The loss of confidence in the financial industrial affect the growth and survival of the financial firms due to reduction in the benefits that flow from their intermediary activities. With regards to banking industry, it may engender crises of confidence among the banking public, impede the going concern status of the bank and ultimately lead to bank failure (Adeyemo, 2012).

Fraud activities in an organisation is internal, external and both. Internal in respect of those that man the organisation comprising shareholders, directors appointed by them and other responsible for the day to day running of the firm. On the other hand external related fraud are perpetuated by factors both human and inhuman aside the firm. According to Adeyemo (2012) fraud in the bank is possible with corroboration of an insider. Nwaze (2006) affirms that most forgeries are perpetuated by internal staff or by outsiders who act in collusion with employees of the bank. Owolabi (2010) classified perpetrators of fraud as management of the banks (otherwise referred to as management fraud), insiders (these perpetrators are purely the employees of the banks), outsiders (include customers and/or non-customers of the banks) and outsiders/insiders (this is a collaboration of the bank staff and outsiders). NDIC (2011) report reveals that 78.26 per cent of fraud which was perpetuated with staff connivance amounted to N900 million losses to the affected banks. Cecilia Ibru, the former CEO and board director of the now-defunct Oceanic bank, was accused of giving her housekeeper loans totalling millions of naira in this case (Kafidipe, Uwalomwa, Dahunsi and Okeme, 2021).

Bank will not fail if there are no impediment to it survival. Banking stability is the absence of an unexpected disturbance in the delivery of credit, payment systems, and banking services (Aroghene & Ikeora, 2022). At such fraudulent tendencies hamper the growth of any organisation. There are agencies like Nigeria Deposit Insurance Commission (NDIC), CBN and Acts so as Bank and Other Institution Act BOFIA section 15, Economic and Financial Crime Commission Act 2004, Special Tribunal (Miscellaneous Offences) Act 1990, Companies and Allied Matters Decree No 19, 1990. (CAMD 1990), and Money Laundering Act aim at mitigating fraud related issues but there are still ceaseless cases of fraudulent action eating deep into the fabric of the financial firms and its resultant effect on the economy at large. Fraud is a major challenge to the entire banking industry; no bank is immune to it and in all facets of life (Olorunsegun, 2010).

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Although the incidence of frauds is neither restricted to the banking industry nor peculiar to Nigeria economy, however the high rate of fraud within financial firms (banks), calls for urgent attention with a view to finding solutions. Several studies capture fraud on bank performance (Willliams & Adeyanju 2021; Adeyemo, 2012; Muritala, Ijaiya, Afolabi, & Yinus, 2020). Others focuses on the Nature, deep-seated causes, Aftermaths and probable remedies (Adewole, 2016; Owolabi, 2010; Nwaze, C. 2006). In view of the aforementioned different methods was used to evaluate the data such as var granger causality analysis and GLS (Muritala, Ijaiya, Afolabi, & Yinus, 2020; Willliams & Adeyanju ,2021) with different research period and findings. Little efforts has been made as regards how the menace can be combated. It is in line with this that this study intends to evaluate the effects of fraud on the stability of financial institution in Nigeria.

Literature Review

Conceptual Frame work

Fraud

Fraud is the wrongful or criminal deception projected to result in financial or individual gain. It is simply false representation. Okpara (2009) found that one of the factors that impacted the most on the performance of the banking system in Nigeria was fraudulent practices. Fraudulent acts comprises , weak board and management oversight; inaccurate financial reporting; poor book-keeping practices; nonperforming insider-related credits; declining asset quality and attendant large provisioning requirements; inadequate debt recovery; non-compliance with banking laws, rules and regulations; and significant exposure to the capital market through share and margin loans (Uchenna, 2013). Fraudulent practices is witness in most sectors and economies. The crash of transnational companies like ENRON, WorldCom Inc. and Global Crossing in the wake of fraud and accounting scandals, for instance, attests to this fact. For this study inaccurate financial reporting; poor book-keeping practices; fraudulent loans and money laundering was used to proxy fraud in the banks and how it affect the stability of the banks.

Financial institutions

FI are company engaged in the business of dealing with financial and monetary transactions such as deposits, loans investments and currency exchange. These institutions encompass a broad range of business operations within the financial service sector such as banks trust companies, insurance companies, brokerage firms, and investment dealers. These institutions vary in size, scope, and geography. Take for instance, insurance companies that is saddled with the task of insuring/assuring the insured/assured in event of risk suffered. Insurance is a contract whereby the insurer promises to reimburse the insured or assured as the case may be in event of loss suffered for a consideration know as premium (Aroghene, 2022). The financial services rendered by financial institutions bank in particular is hampered by shameful activities (fraud). Fraud leads to loss of money belonging either to 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 by the equity capital of the bank, impair the banks financial health and constrain its ability to extend loans and advances for profitable operations.

In extreme cases, rampant and large incidences 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 detection, prevention and protection of assets ((Uchenna, 2013).for the purpose of this research the financial institution (bank) stability will be evaluated using the financial risk measure known as the zscore. Zscore is calculated using the return of asset plus equity asset ratio divided by the standard deviation of return of asset.

Theoritical Framework

Fraud Triangle Theory

Cressey (1973) described the classical fraud theory and designated the propensities for fraud as a triangle of perceived, perceived pressure and perceived rationalization. Cressey established that for fraud to occur there must be a reason. He also make certain that the perpetrator must formulate some morally acceptable idea to them before engaging in unethical behavior and if fraud perpetrators are given the opportunity they are most likely to commit fraud.

Fraud Diamond Theory

Capability is a major element of this theory This theory was earlier presented by Wolfe and Hermanson in the CPA Journal in December 2004. Wolfe and Hermanson (2004) argued that although perceived pressure might coexist with an opportunity and a rationalization, it is unlikely for fraud to take place unless the fourth element (capability) is also present. capability is of utmost importance when it concerns a large-scale or long-term fraud (Albrecht, Williams, & Wernz, 1995).

Theory of Deviations

It is a variance from the normal procedure or pertains. The perpetrators are limited to the available opportunities and also concentrate on ways to conceal their guilt. Generally deviations from the accepted procedures are the first symptoms of fraud.

Empirical Review

Uchenna (2013) evaluated the impact of fraud and fraudulent practices on the performance of banks in Nigeria within the period 2001-2011. The paper found that the percentage of mobilized funds lost to fraud was highest between 2001 and 2005. Owolabi (2010) studied fraud and fraudulent practices in Nigeria banking industry. Various theories of fraud are examined and detailed analysis of various causes, prevention and control strategies were emphasized. Owolabi concluded that there is an urgent need for the responsible agents of control to put adequate measure in place to block major loop holes, and adequate sanctions to punish and discourage culprits must be devised. kpefu & Odejimi, (2014) also investigated factors eliciting fraud in Nigerian banking sector. It was discovered that high bank deposit were primarily responsible for a high rise fraudulent occurrences in the Nigerian banking sector particularly management fraud, as most banks failed in their primary role of lending to the real sector of the economy and because of this there are excessive idle funds in the banks which necessitated management fraud and other insiders' abuse. David, Lucey & Winne, (2015) also assessed banking and occupational fraud risk in Kenya, their findings showed a positive correlation between bank size and occupational fraud risk, also the result showed a significant influence of bank size on occupational risk in Kenyan commercial banks. Funmi, Omotayo, Isaac & Olukayode (2018) examined bank fraud and its effect on Nigerian Economy- A study of selected quoted banks using fraud involved, actual loan and money laundering as proxy of fraud .They concluded that there is a great level of interaction between bank fraud and economic development of Nigeria. Willliams and Adeyanju (2021) examined the impact of fraud on financial performance of deposit money banks: Evidence from Nigeria. Their main aim of the study was to investigate if variables like computer fraud, managers looting; inappropriate auditing, peer group pressure affect bank performance. The GLS regression results revealed that there are negative relationships between bank frauds and performance while the z-test shows that bank frauds affect deposit money bank performance in Nigeria.

Methodology

To account for fraud and its effect on financial institution (banks) stability in Nigeria, the study made used of convenience sampling method. The study population are the commercial banks in Nigeria. Seven (7) banks resident in Abraka town in Ethiope East Local Government of Delta State constitute the sample size. These banks were selected for the study due to proximity and sure to have witness one form of fraud. Primary data were collected through the administration of questionnaire precisely to: tellers, accounts opening section, and loans department. The study target population is one hundred and ten (110). By the application of the formular for sample size by (Kothari, 2014) the sample size for the study came at eighty-six (86) approximately. Out of the eighty-six questionnaires seventy(70) was returned amounting to 81.4% response rate Secondary data were also collected from the financial statements of the selected commercial banks for the last ten years (2013 to 2022). Correlation and analysis of variance (ANOVA) was employed to explain the relationship between the variables while multiple regressions with the aid of statistical package for social sciences (SPSS) version 23 was used to test the study hypothesis. This study model after that of Everline and Njenga (2016).

The model is defined as: BSTA= f (IFR,PBP, FRL,MOL)
The function model was incorporated econometrically into the regression model as:

$$BSTA = \beta_0 + \beta_1 IFR + \beta_2 PBP + \beta_3 FRL + \beta_4 MOL + \varepsilon$$

Where;

$$BSTA = \text{Bank Stability measured by } \frac{ROA + Equity/Asset}{\text{Std. dev. of ROA}}$$

IFR = Inaccurate Financial Reporting
PBP = Poor Book-Keeping Practices
FRL = Fraudulent Loans
MOL = Money Laundering
ε = Error Term
β_0 = Intercept
β_1–β_4 = Coefficient of the Independent Variables.
The a priori expectation is β_1, β_2, β_3 is lesser or greater than 0.

Result and Discussion

Table 1: Summary of Correlation Analysis

VARIABLES		IFR	PBP	FRL	MOL	BSTA
IFR	Pearson Correlation	1				

	Sig. (2-tailed)					
PBP	Pearson Correlation	.603**	1			
	Sig. (2-tailed)	.000				
FRL	Pearson Correlation	.521**	.653**	1		
	Sig. (2-tailed)	.000	.000			
MOL	Pearson Correlation	.533**	.674	.544	1	
	Sig. (2-tailed)	.001	.000	.000	.000	
BSTA	Pearson Correlation	.630**	.590**	.621**	.722**	1
	Sig. (2-tailed)	.001	.000	.000	.000	

Correlation is significant at 0.01 level of (2-tailed)

a. **Likewise N=70**

In table 1, the correlation coefficient between bank stability (BSTA) and inaccurate financial reporting is .603. the relationship can be said to be positive due to the absence of a negative sign and said to be strong because the coefficient is within the range of 0.5 to 0.7. Also, poor book keeping practices(PBP) has a coefficient of.603 which is positive and strong. Similarly, in the table the coefficient of fraudulent loan is .521. from the coefficient value it is convenient to say that the relationship is positive and moderate. Likewise, in table 1 money laundering (MOL) has a coefficient .533 which depicts a positive and moderate relationship BSTA. From the table it can be agreed that the correlation between the dependent and independent variables assume moderate/strong relationship that is positive.

Table 2: Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.803[a]	.796	.627	1.628

a. Predictors: (Constant), IFR,PBP, FRL, MOL
b. Dependent Variable: BSTA

The outcome in Table 2 specify that R = .803 and R2 = .796. The R value of .803 point to a robust linear relationship between Fraud construct (IFR,PBP,FRL &MOL) and Financial Performance(BSTA) selected banks in Nigeria. This means that fraud has a strong influence on BSTA. The R2 indicates that approximately 79.6% of the variations in BSTA are explained by the model : $\beta 0 + \beta 1IFR + \beta 2PBP + \beta 3FRL + \beta 4MOL$ and 20.4% of external variables can still be investigated. In line with the assumption of (Zygmont & Smith, 2014), this model is found to be accurate.

Table 3: ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	110.839	4	7.010	62.614	.004[b]
	Residual	70.047	65	5.066		
	Total	180.886	69			

a. Dependent Variable: BSTA
b. Predictors: (Constant), IFR, PBP, FRL, MOL

The ANOVA analysis proposed whether the variation in the independent variables clarify the observed variance in the aftermath. In Table 3, the value for the F statistics is 62.614 and the significance ratio is 0.004 which is less than 0.05, which settles that the regression model is statistically significant.

Table 4 Coefficients[a]

		Unstandardized Coefficients		Standardized Coefficients		
Model		B	Std. Error	Beta	t	Sig.
1	(Constant)	-10.088	2.322		-4.344	.000
	IFR	-.796	.370	.305	-2.151	.001
	PBP	-.537	.422	.853	-1.273	.004

FRL	-.447	.292	.485	-1.531	.002
MOL	-.065	.075	.086	-.867	.003

a. Dependent Variable: BSTA.

Discussion of Regression Result

In table 4, inaccurate financial reporting (IFR) has beta coefficient of -.796 with a t value of -2.151 resulting in a sig value of .001. The values depicts that IFR has a negative and significant influence on financial institution stability in Nigeria within the period reviewed. Thus an increase/decrease in IFR would lead to reduction/intensification in financial institution stability in Nigeria. This is in agreement with the idea of Williams and Adeyanju (2021) .

Likewise, poor book-keeping practices (PBP) has a coefficient of- .537 with a t value of -1.273 and an associated sig of .004. The PBP values shows that it has a negative and statistical influence on financial institution stability in Nigeria. This outcome differ from the report of David, Lucey & Winne, (2015) and Funmi, Omotayo, Isaac & Olukayode (2018).

Similarly, fraudulent loans (FRL) has a coefficient of -.447 with a t value of -1.531 with a sig value of .002. Judging from the values FRL has a negative and significant influence on financial institution stability in Nigeria whereby an increase/decrease in FRL would lead to decline/growth in financial institution stability (BSTA) in Nigeria. Again this outcome agreed with the opinion of Muritala, Ijaiya Afolabi and Yinus (2020).

Furthermore, money laundering (MOL) has a coefficient of -.065, a t value of -.867 with a sig value of .003. From the value of MOL, an increase/decrease in MOL would lead to obstruction/upshot in BSTA. This correspond to the finding of Williams and Adeyanju (2021).

Conclusion and recommendation

The effect of fraud was examined on the stability of financial institution in Nigeria for the last ten (10) years. IFR, PBP, FRL & MOL was used as representation of fraud while bank stability was used to represent financial institution stability. Seven banks resident in Abraka Ethiope East was used as the sample of the study. The coded response coupled with the financial data of banks understudied was analysed and the results showed that all the fraud elements (IFR, PBP, FRL & MOL) does has negative significant effect on financial institution stability in Nigeria.

Sequel to the findings the study recommend that measures (internal &external) should be put in place in the institution to curb fraud from its conception in order to reduce if not eliminate fraud in the financial service sector. Also the penalty for fraudulent activities should be spelt out clearly and publicized as this would discourage fraudulent tendencies.

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