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Research Article

Fraud And Financial Performance Of Banks In Nigeria

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ARTICLE INFO **ABSTRACT**

Incidence of fraud is a global problem affecting the society across all works of life and no person or organisation is immured. This study investigated fraud and financial performance in Nigerian banks for the period 2002 to 2016. Data analysed were sourced from Central Bank of Nigeria (CBN) statistical Bulletin and NDIC annual reports. The result identified the amount involved in fraud (0.3354) to have affected the banking sector performance. The study concluded that fraud is harmful and recommended that there is need for the establishment of adequate internal control system, capacity building and legal framework for fraud prevention.

Keywords: Financial performance, Fraud, Fraud prevention.

JEL Code: E5, E51, G01, G21

Introduction

Fraud has been a timeless phenomenon in the history of human existence. In Biblical times, Jacob, working with his mother, deceived Isaac to receive the blessings meant for Esau. This historical perspective painted fraud as a complex deception problem since the perpetrators leave no trail. As such, fraud affects organisations through loss of funds, loss of customer confidence, and time wasted through investigations. According to the 2012 Annual Survey of the Association of Certified Fraud Examiners (ACFE), a typical organisation loses 5% of its revenue to fraud each year. Also, Kroll (2013) submitted that globally 70% of companies reported suffering from at least one type of fraud representing, an increase from the previous 61% in 2012. It is, therefore, imperative that organisations minimize the chances of fraud occurring.

Concerning Nigeria, Enofe et al. (2015) claimed that financial crime generally is believed to be a fundamental problem affecting the economy and hindering economic and development growth. More so, there has been a dramatic increase in financial crime across the globe with more occurrences in the banking industry. Adeniyi (2016) stressed that despite the control and regulation in the Nigerian banking sector, financial crimes such as embezzlement, bribery, bankruptcy, security fraud, employee theft, payroll fraud, and management theft take different forms in the banking sector.

According to Henry and Ganiyu (2017), a large number of financial statement frauds in the banking industry emerged from the inability of the law enforcement agents to successfully track-down perpetrators. Gates and Jacob (2013) asserted that fraud has become a standard feature in most organisations. Hence, Gates and Jacob (2013) argued that the internet provided and strengthened the opportunities for fraudsters to commit fraud more often than before. According to the United States Department of Justice (2012), within six years, the Federal Bureau of Investigations (FBI) reported Suspicious Activity Reports (SARs) amounting to $207,051 for crimes related to cheque fraud, kitting fake cheques, and imitated negotiable instruments. All these frauds pertained to activities amounted to 47 percent which is approximately $7 billion in losses. Fraud is also evident in many African countries' financial institutions as indicated by KPMG Barometer (2012), Nigeria, Kenya, Zimbabwe, and South Africa make up 74 percent of all misrepresentation cases detailed in Africa. In the East African area, Kenya emerged with 7.75 percent of detailed misrepresentation cases, Uganda has 2.98 percent, and Tanzania with 2.78 percent.

In Nigeria, deception is refered to as one of the significant factors that have impacted the overall performance of commercial banks (Okpara, 2012). The Nigeria Deposit Insurance Corporation 2015 annual reports and statement of accounts for the banking sector stated that 12,279 reported fraud cases occurred in 2015. This figure represented an increase of 15.71 percent over the 10,612 recorded in 2014 (Ebhodaghe, 2015). According to Akinyomi (2014), management causes of fraud are those actions or omissions by management of organisations resulting from weak internal control systems. Personal causes of fraud are those perpetrated by individuals due to undeveloped character resulting from poor upbringing. Social causes of fraud are those enhanced due to poor societal values where the society adores a rich person without checking the sources of wealth.

Finerty et al. (2016) also argued that financial fraud forces the actors or the agents involved to act fraudulently to portray an excellent image to enhance the firm's financial performance. It indicates that firms affected by financial fraud could have exhibited attractive or a positive performance after fraud as one way of covering up the fraud. Finerty et al. (2016) argued that a firm's performance after some time preceding the fraud could face inevitable adverse shock, an indication that fraud could probably have a negative effect on the performance of an organisation. It is against this background that this study investigated the effect of fraud on the financial performance of deposit money banks in Nigeria. The paper investigated (a) the effect of numerical volume of fraud on financial performance and (b) the financial amount involved in fraud on the financial performance of deposit money banks in Nigeria

Literature Review

This aspect of the study reviews the work of previous researchers in related field to enhance appropriate empirical decision. It is an aspect that evaluates previous studies with the view to situate the current study. This section was divided into three segments: conceptual review, theoretical review and empirical review.

Concept of Fraud

The concept of fraud elicits different perspectives as; Agwu (2013) defined it as an illegal act characterized by deceit, concealment, or violation of trust. These acts are not dependent upon the threat of violence or physical force. Fraudulent acts are perpetrated by parties and organisations to obtain money, property, or services to avoid payment or loss of services or to secure personal or business advantages. It has been viewed as an illegal act involving obtaining something of value through wilful misrepresentation. According to ACFE (2012), fraud is the use of one's occupation for personal enrichment through the deliberate misuse or misappropriation of the employing organisation's resources or assets. Akinyomi (2010) position is that fraud is 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 that is intentionally practiced to gain an illegitimate advantage. Therefore, for any action to constitute fraud there must be a deceitful objective to benefit on the part of the perpetrator at the disadvantage of another person or group.

According to Joseph et al. (2016) and Udeh and Ugwu (2018), fraud is a human problem, not an accounting problem or internal control problem. Hence on this premise, the most sophisticated control systems cannot eliminate all risks of fraud an individual or an organisation will face. Therefore, to understand the concept and management of fraud, there is a need to understand the man that perpetuates fraud. While in the submission of Arjan (2016), fraud is complex and elusive, the definitions of fraud from many perspectives depend on the discipline of the individual such as behavioral social sciences, legal and other disciplines. Arjan (2016) further expanded that our understanding of financial fraud can be aided by categorizing financial fraud into three: financial statement fraud, financial scams, and fraudulent financial mis-spelling.

Financial Performance

Authors' perspectives differ on the terminology and definition of performance (Venkatraman & Ramanujam, 1986). For instance, some researchers measured firm performance-based return on investment (ROI) or return of assets (ROA), others addressed it from the market or human resources field, but more appropriate is accounting-based measurements (Hax & Majluf, 1984). As such, performance is a multidimensional concept. The definition may depend upon the indicators used to assess performance (Lumpkin & Dess, 1996; Combs, Crook & Shook, 2005; Venkataraman & Raamanujam, 1986). Researchers insist that financial measures are more reasonable in measuring a firm's performance than others (Cheng & McKinley, 1983; Dalton et al., 1980). The significant advantages of financial measures are their usefulness for practitioners (Cheng & McKinley, 1983). Numerous researchers have posited multiple dimensions of firm performance (Venkatraman & Ramanujam, 1986; Walker & Ruekert, 1987; Wiklund & Shepherd, 2005), but this paper is aligned with financial measures of performance to be more reliable with multiple dimensional approaches.

Empirical Review

Studies relating to fraud and financial performance with varying results have been investigated by scholars; for instance, Udeh and Ugwu (2018) study found that bank deposits increased with fraud cases reported. It further revealed a negative but insignificant relationship between fraud and bank deposits. Likewise, Verman and Singh (2017) discovered a negative and significant influence of frequency and severity of fraud on profitability as measured by ROA, ROE, and ROI.

Kanu and Okorafor (2013) demonstrated that the most frequent type of fraud in the Nigerian banking industry is fraudulent withdrawals. Similarly, Chiezey and Onu (2013) identified poor internal control as a catalyst for increase in fraud and fraudulent activities. Also, Kiragu et al. (2013) results revealed a negative and insignificant effect of bank growth on occupational fraud risk in commercial banks in Nigeria. Further, Odhiambo (2013) found that financial fraud loss and liquidity ratios had a strong positive and significant influence on the financial performance of commercial banks. Building on previous studies, Basin (2015) found poor employment practices and lack of effective training, over-burdened staff, weak internal control systems, and low compliance levels of Bank Managers, Officers, and Clerks.

Adetiloye et al. (2016) study showed that while internal control is effective against fraud not all staff are committed to it. Nevertheless, Offiong et al. (2016) found that the problems of Nigerian banking sector frauds require strong inter-agency collaboration, public education and cross border cooperation to accomplish sustainable success. In addition, Inaya and Isoto (2016) investigated the social impact of fraud on the Nigerian banking industry from 1990 to 2014 and found that a negative social impact of fraud exist in the Nigerian banking industry. In Adeniyi (2016) work, the results showed that forensic auditing significantly affects financial fraud control in Nigeria (DMBs). Also, Osuala et al. (2016) found that fraud significantly impact on commercial bank loan and advances in Nigeria.

The paper reviewed the fraud triangle theory developed in 1973 by Donald Cressey, a criminologist who established that for fraud to occur there must be a reason. Donald related to three factors (pressure, opportunity, and rationalization) that must be present for an offense to happen. The perpetrator must formulate some morally acceptable idea before engaging in unethical behavior, and if fraud perpetrators are given the opportunity, they are most likely commit fraud. Hence, Donald determined three types of pressure, personal, employment stress, and external pressure. Donald defined the pressure to commit fraud as, the source of heat for the fire. According to Shuchter and Levi (2015) pressure to commit fraud by corporate organizations might be heightened during financial distress. The pressure perspective of the fraud triangle asserts that individuals and organisations circumvent legislation when experiencing financial pressure.

Lokana (2017) submitted that these individuals go through strain when their efforts to attain material wealth are unattainable because of blocked opportunities. Hence, workers feel deprived and revert to illegitimate means to acquire material success. Lokana (2017) further asserted that when executives feel pressured because of poor financial performance strain arises. Therefore, financial pressure creates a discrepancy between achieving performance targets and the legitimate means to meet those targets. By implication the more severe the financial strain experienced by the organisation, the greater the pressure to maximise profit through fraudulent behaviour.

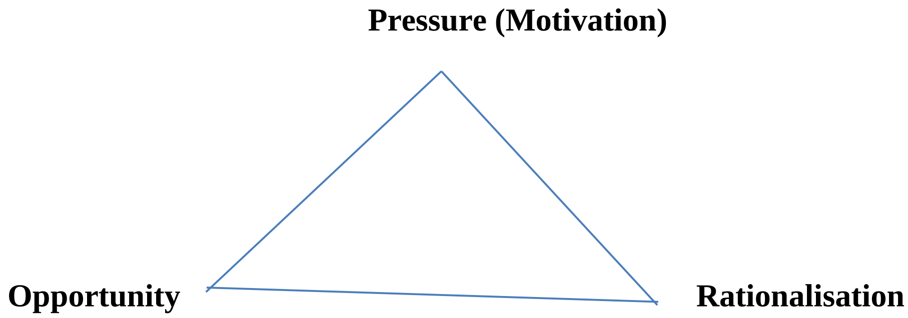

Figure 1: Fraud Triangle

The Fraud Diamond Theory

The fraud diamond theory was first proposed by Wolfe and Hermanson in December, 2004. The assumption is that another element named capacity was added to the three initial fraud components of the fraud triangle theory. Wolfe and Hermanson (2004) argued that although perceived pressure might coexist with an opportunity and a rationalisation, it is unlikely for fraud to take place unless the fourth element (capacity) is also present. Mackevicius and Giriunas (2013) submitted that not every person who possessed motivation, opportunities and rationalisation may commit fraud due to the lack of the capability to carry it out or conceal it. Albrecht, Williams and Wernz (1995) opine that this element is important when it concerns a large-scale or long-term fraud. Furthermore, Albrecht et al. (1995) believe that only the person who has an extremely high capacity will be able to understand the existing internal control, to identify its weaknesses and to use them in planning the implementation of fraud. Therefore, this paper is anchored on the fraud triangle theory and the fraud diamond theory to broaden the frontiers of knowledge.

Methodology

This research work is an ex-post facto research design, which examined fraud and financial performance of banks in Nigeria using time series data dating from 2002 to 2016; this was premised on the availability of data. Descriptive statistics and inferential statistics were employed in this study. The research design was built on a similar study by Udeh and Ugwu (2018) on fraud in the Nigerian banking sector. The model specification was a mathematical model which explains the effect of the independent variable (Fraud) on the dependent variable (Financial Performance) and was adopted from the work of Abdulrahman et al. (2012). The mathematical equation below, therefore, shows the effect of the independent variable on the dependent variable in a linear form as thus:

FP = *f*(FRD, TAF) . . . . equation 1
FP = α_0 + α_1 **FRDCAS** + α_2 **FRADAMT** + μ . . . . equation 2
Where:
FP = Financial Performance (Measured using Credit to private sector (CPS) as a ration of GDP
FRDCAS = Total Number of Fraud Cases
FRADAMT = Total Amount Involved in Fraud
α_0 = Intercept
μ = Disturbance Term
α_1 = Coefficient of the Independent Variable
Note: All variables are in their natural logarithm form
The researchers' a priori expectation was that a significant relationship will exist between fraud and financial performance of banks in Nigeria. This means that for the established objectives, significant relationships are expected on fraud and financial performance of banks in Nigeria. The researchers observed high level of integrity, transparency and diligence in the process of data collection, analysis, and interpretation in conducting the research. The research did not obtain information from any respondents, the official website of the selected companies were visited to collect information which was provided in line with their legal and regulatory requirement, information were obtained and used basically for the purpose of the research work. The study was carried out in accordance to ethical consideration, rules and guidelines, which prevented data falsification, manipulation misrepresentation, and hence free of bias and similarity index conform with standard.

Results and Discussion

In this segment, the result obtained from the time series data regression in assessing fraud and financial performance of banks in Nigeria, were presented and discussed. The results from various analyses were interpreted and discussed using descriptive and inferential statistic. Also, the section presented statistical features relating to measuring the independent and dependent variables.
This section of the study provides empirical on the relationship amid fraud and financial performance of banks in Nigeria and ends with discussion of finding on result obtained.

Table 1: Descriptive Statistics

DESCRIPTOR	CPS	FRADAMT	FRDCAS
Mean	2.845684	9.634334	7.257025
Median	2.876926	9.466497	7.286876
Maximum	3.604026	10.88786	8.125631
Minimum	2.403427	8.483051	6.679599
Std Dev.	0.358491	0.680059	0.425473
Skewness	0.634094	0.313175	0.377268
Kurtosis	2.654695	2.400299	2.541234

Source: Researchers' Compilation (2019)

CPS mean credit to private sector, FRADAMT represents the total amount involved in fraud, and FRDCAS stands for total number of fraud case. Table 1 shows the descriptive statistics of the variables under study. The mean value of the variables shows that all the variables have positive values, and FRADAMT has the highest value (9.63), followed by FRDCAS (7.25) and CPS (2.84). The minimum and maximum change ranges from a positive to positive in all the case variables. In addition, the standard deviation shows that FRADAMT was highly volatile, having the highest value (68%), FRDCAS (43%) and CPS (36%) are relatively low. The results also show that all the variables under investigation were positively skewed.

Table 2: Regression Analysis

Variable	Co-efficient	Std. Error	t-Statistic	Prob.
C	-2.070589	1.267811	-1.633200	0.1335
FRADAMT	0.335363	0.112212	2.988660	0.0136*
FRDCAS	0.232227	0.179355	1.294791	0.2245
R-Squared	0.837683			
Adjusted R-Squared	0.765220			
F-Statistic	28.800086			

Prob (F-Statistic)	0.00000

Dependent Variable: FP; * means Significant at 5%

Interpretation

The regression analysis results in Table 2, as conducted to test the effect of fraud on the financial performance of Nigerian banks, show the coefficient of the total amount involved in fraud (FRADAMT) was 0.3354. The result implies that FRADAMT has a positive effect on banking sector performance as measured by credit to the private sector as a ratio of GDP. Further, the coefficient result was statistically significant, as evidenced by the probability value of 0.0136. The results revealed that the total number of fraud cases affected the financial performance of deposit money banks in Nigeria. The finding placed a moral burden on banks to increase their requirements regarding staff qualifications, internal control mechanisms, and ascertaining that references are not fictitious.
Total number of fraud cases (FRDCAS) coefficient had a value of 0.2322, suggesting a positive effect of fraud cases in Nigeria on financial performance of banks. However, the probability value of 0.2245 indicates that this effect was not statistically significant. The implication is that the frequency or number of fraud exhibited has no material effect on financial performance; the physical amount of money, affected the financial performance of banks. The adjusted R^2 of the model shows that 76.5% variations in financial performance of banks in Nigeria can be attributed to changes in the reported occurrence of fraud, while the remaining 23.5% variations were caused by other factors outside the model. The result means that in Nigeria, the variables chosen to investigate the problem were appropriate in explaining the level of bank performance. The *F*-Statistic that measures the joint statistical influence of the explanatory variables in interpreting the dependent variable was statistically significant at 5% level. This result can be described as scientifically ideal, robust, and reliable as the model was treated to avoid spurious results. The R-squared was strong even when adjusted for degrees of freedom.

Discussion of findings

The aggregated finding from this paper revealed that fraud had a significant effect on the performance of banks, but the individual measures result varied. While on the one hand, the total amount of fraud had a positive and significant effect on Credit to the private sector (CPS) as a ratio of GDP; on the other hand, the total cases of fraud had a positive but insignificant effect. Although these results corroborate other studies findings, the direction of the effect in terms of positive/negative or signifcant/insignifcant varied, but the recurring empirical observation is that fraud affects the performance of banks. For instance, the paper's result supports the study by Odhiambo (2013) that financial fraud loss and liquidity ratios had a strong and significant influence on the financial performance of commercial banks in Nigeria. Additional, Chiezey and Onu (2013) study findings revealed that poor internal control leads to an increase in fraud and fraudulent activities. Hence, only internal control is not sufficient in curbing the menace of fraud.
Adeniyi (2016) examined the effect of forensic auditing and financial fraud in the Nigerian deposit money banks (DMBs) and found that forensic auditing has significant effect on financial fraud control in Nigeria. Osuala et al. (2016) added that fraud significantly impacts on commercial bank loans and advances in Nigeria. Conversely, Verman and Singh (2017) findings revealed that there is negative and significant influence of frequency and severity of frauds on profitability as measured by indices of ROA, ROE and ROI. Udeh and Ugwu (2018) stressed that as bank deposits increased the fraud cases reported also increased. Although there is positive but insignificant relationship between fraud case increase on one hand and bank deposits and bank assets on the other hand. Therefore, the researchers' finding aligns with the position of previous scholars (Abdulrahman et al., 2012; Kiragu et al., 2013; Osuala et al., 2016; Udeh & Ugwu, 2018) on fraud in Nigerian banking sector.

5.0 Conclusion and Recommendation

In compliance with the objectives of this study, it has been established that fraud affects financial performance in Nigeria. The study applied credit to private sector as a proxy for financial performance, while the number of fraud cases and the amount recorded were used as proxies for fraud within the period of 2002 to 2016. The results obtained revealed that the coefficient of total amount involved in fraud exhibited a significant positive relationship with financial performance as measured by credit to private sector as a ratio of GDP. In addition, total number of fraud cases coefficient revealed that a relationship existed with financial performance, but the relationship was not statistically significant. The overall effect of fraud on financial performance showed that fraud affected banks financial performance in Nigeria significantly.

Towards the possibility of eradicating fraud in banking sector and improving the performance of the banking sector, it is recommended that banks build strong internal control mechanisms, strengthen legal framework for fraud prevention, and conduct training in the aspect of honesty and integrity, and not only technical skills. Future studies should apply other measure of fraud on a country's GDP through secondary data and extend such to West Africa region.

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APPENDIX

Table 1: Data

Years	Total Number of Fraud Case	Total Amount Involved (Billion)	CPS/GDP (%)
2002	796	12,919.55	11.9
2003	850	9,383.67	11.1
2004	1,175	11,754.00	12.5
2005	1,229	10,606.18	12.6
2006	1,193	4,832.17	12.3
2007	1,553	10,005.81	17.8
2008	2,007	53,522.86	28.5
2009	1,764	41,266.00	36.7
2010	1,532	21,291.41	18.7
2011	2,352	28,400.86	16.9
2012	3,380	17,097.00	20.6
2013	822	19,149.00	19.7
2014	10,612	25,608.70	19.2
2015	12,279	18,020.00	19.8
2016	16,751	8,680,00	20.8

Source: NDIC, Annual Reports (2016)