The role of internal audit in prevention of fraud in nigeria banks essay sample

Literature, Russian Literature

ABSTRACT

This study investigated the role on internal audit in the prevention of fraud in banks taken Equitorial Trust Bank (ETB) as case study. It specially examined how the bank organized its internal audit system with the hope of assessing how it is used for the purpose of controlling and preventing fraud in the bank and examined the importance of internal audit on the performance of the bank in terms of their its services. Secondary data obtained from the headquarter of the bank in Lagos was employed for the study. Both stratified and simple random sampling techniques were used to select the sample for this study. First, the bank was stratified into departments after which samples were selected in each department using simple random sampling techniques.

The data generated were analysed using frequency table and simple percentage statistical technique. The results of the study revealed that the internal audit system of the bank is sound and efficient. It is adequate in checking and controlling fraudulent activities within and outside the bank system. Also, it was discovered that the internal audit system of the bank has improved the performance of the bank staff in terms of uprightness in duty, service delivery to customers and proper documentation of accounts with no error. The conclusion drawn from the study is that for any organization to ensure fraudless activities and guide against financial distress must undertake good and sound internal audit system. This will ensure proper functioning of the financial system.

CHAPTER ONE

INTRODUCTION

1. 1BACKGROUND OF THE STUDY

Internal Audit is " an independent appraisal function established by the management of an organization for the review of the internal control system as a service to the organization. It objectively examines, evaluates and reports on the adequacy of internal control as a contribution to the proper economic, efficient and effective use of resources" Mill champ The internal audit is the function responsible for the independent examination and assessment of the adequacy and effectiveness of the internal control of banks, including the evaluation of the corporate office and company sectors to ensure that business objectives are achieved in an efficient manner. Fraud is a major economic crime which our banking industry faces today. Many countries do not have a legal definition, but the laws invoked to obtain a prosecution usually rely on other specified offences having been committed. These could include conspiracy, theft and forgery. But a fraud cannot occur without deception, which usually implies concealment. Fraud is, therefore a premeditated act and does not come about because of an omission or error.

A fraud may occur when an innocent error or mistake, that has not been identified, is taken advantage of by a fraudster. The increase in criminal activities has led to money laundering fears in banks and other financial institutions. By its very nature fraud is a clandestine operation. Perpetrators of frauds do not advertise their activities or their methods. There is also the perception -that fraud is a " victimless crime"; that banks can well afford the losses. The extent of fraudulent activity worldwide is unknown but is perceived to be on the increase. This nefarious activity could lead and has actually led to crisis in and the collapse of many financial institutions worldwide. The demise of the Bank of Credit and Commerce International (BCCI) London is a very good example. The increasing wave of fraudulent activities in financial institutions poses a threat to their stability and survival if it is not arrested.

Fraud is a business risk which may result in financial loss to banks and their customers, loss of confidence in financial institutions, depletion of shareholder’s funds and capital base. Failures of internal control have almost always been identified as a main contributing factor to many catastrophic bank failures. Therefore, it is the responsibility of management to put in place systems and processes that will prevent and detect fraud within the banks. Internal auditors can assist them in this task through their assessment and evaluation of the internal control strategies; through their involvement in the improvement of internal control; and through their provision of assurance that the organization operates an effective system of internal control. To the layman, internal auditing is still perceived as just another financial function, which it isn’t. In some organizations, the financial director controls the internal, auditing activities thereby undermining its independence and objectivity. In others, internal auditing is just an extension of – the accounts department.

From time to time, the internal audit unit of a bank detects fraud and errors. This is, however, not the main role of internal auditing. Internal audits accepted role is to provide an independent appraisal of the adequacy, application and effectiveness of internal control arrangements put into place by management. Internal audit should also add value to all the banking operations by facilitating the identification and assessment of risks at all levels. However, despite all the above roles of internal audit, fraudulent activities continue to increase at alarming rate. For instance, in year 2000 according to the returns of commercial banks on frauds and forgeries, 403 cases of fraud were reported involving 63 banks. In 2001, 943 cases were reported involving 75 banks. In 2002, the number of fraud cases has risen as high as 981 cases.

1. 2STATEMENT OF THE PROBLEM

The banking industry in Nigeria has recently passed through a wave of distress, which has resulted in the failure of several banks. This wave of distress is mainly caused by fraud and other criminal activities committed in banks. It is expected of every bank to maintain an effective system of internal control, and management is required to assert as to the effectiveness of those controls. However, despite thorough scrutiny employed by banks in carrying out their banking functions~ the incidence of fraud is still on the increase. The topic of how the internal audit department of banks prevents fraud within the banks is the main focus of this research work.

The questions that readily comes to mind are How effective is the role of internal auditing in the investigation of criminal activities like fraud, forgery and theft of bank assets and, ultimately, in preventing and controlling these criminal activities in the banking industry? How effective and efficient are the internal auditors in controlling and preventing fraud within the bank? And what is the importance of internal audit unit in the performance of service by banks? Providing answers to these questions is the main pre-occupation of this study

. 1. 3RESEARCH OBJECTIVES

The occurrence of fraud and other financial crime in the banking industry has negative effect on the ability of the individual banks to render effective services to the public from which investible funds are sought. Thus, the objectives of this study are to

i) appraise the effectiveness and efficiency of internal auditors in the control and prevention of fraud in banks. ii) evaluate the independence of internal auditors from the activities audited. iii) examine the proficiency of internal auditors.

iv) examine the importance of internal audit unit in the performance of service by banks. .

4SIGNIFICANCE OF STUDY

The responsibility for the prevention and detection of fraud and error rest with the management, through the implementation and continued operation of an adequate internal control system. Such a system should contribute highly to the reduction of possibility of frauds in banking system. However, many works have been written on the role of the external auditors in the control and prevention of fraud and other financial crime, only few have been done on the role of internal audit in the detection, control and prevention of fraud in the banking industry. This research work aims to be of significant assistance to banks and other financial institutions in the development of a viable system of internal control.

Fraud and forgeries apparent in the industry have been of negative influence on the growth and development of the economy. Banks are custodian of public money mobilized for the purpose of performing the function of financial intermediation. Thus, fraud and forgeries reduce the public confidence and trust in the banking sector of any nation who is the source of the investible funds mobilized by banks. This study will suggest practical approaches to the way the internal audit of a bank can be made use of in controlling the negative development. It will also help various banks in building a strong and formidable internal control system.

1. 5SCOPE AND LIMITATION OF THE STUDY

This research work is done to appraise the role of the internal audit of banks in Nigeria as it relates to fraud prevention and control. This study will suggest practical approaches to the way the internal audit of a bank can be made use of in controlling the negative development. It will also help various banks in building a strong and formidable internal control system. Due to time and financial resource constraints, this project cannot cover all banks in Nigeria. Also, banks are very reluctant in discussing their operating strategies with any researcher for fear of competitive advantage opportunity to their detriment. Hence, the use -of secondary data for this research works.

CHAPTER TWO

REVIEW OF RELATED LITERATURE

2. 1 INTRODUCTION

Fraud is a major economic crime being perpetrated in our banking industry in recent times. It is a business risk which the barking industry is facing today. The advancement in technology has led to more sophisticated ways of engaging in bank fraud. This criminal activity has led to the closure of some financial institutions world wide, like the Bank of Credit and Commerce in London, and if not checked, can lead to the collapse of many more. Fraud, according to Webster's New World Dictionary, is the " intentional deception to cause a person to give up property or some lawful right". The Association of Fraud Examiners (1999) Report to the Nation on Occupational Fraud and Abuse further defines occupational fraud as " the use of one's occupation for personal enrichment through the deliberate misuse or misapplication of employing an organization's resources or assets". Fraud is used only to refer to irregularities involving the use of criminal deception to obtain an unjust or illegal advantage. According to Aderibigbe (2005), there are four theories relevant to fraud. They are;

Theory of concealment:

This theory states that confusion is deliberately introduced by the team before, during and after an act of theft to conceal it or to assist in its commission. Concealment may divert attention from the shortage, disguise, confuse or delay its discovery or prevent identification of the thieves. But theft may not be concealed for one or two reasons: i. Concealment is not necessary because the victim's record will not disclose the loss ii. Although the loss may be uncovered, records are insufficient to identify the thieves; iii. The victim allows the theft.

In a larger model, concealment is a fundamental element of most organized fraud. It can therefore be defined as " a manipulation accounting records or misrepresentation of a physical or personal or commercial reality intended to: (a)Hide, disguise or alter an account or inventory, account discrepancy before, during or after a theft act. (b)Enable the thief to obtain or continue to obtain a false advantage by the session. (c)Disguise, confuse or delay the recognition of the thieves' guilt to establish a plausible excuse for dishonesty". Theory of deviation:

Fraud is an abnormal behavior. Criminals are limited in the opportunities offered to them and the ways in which they can hide their guilt. These limitations and the pressures the criminals apply to surmount them, frequently result in reasonable deviations from suitable behavior and procedures. Often deviations from suitable procedures are the first sign of fraud. Theory of minimal and general collusion:

Collusion is a factor in many frauds. It usually occurs under two different situations: i. To share the benefits of low skill frauds among the maximum number of people-institutionalized fraud for general collusion. ii. To provide the necessary opportunities, resources or skills to commit fraud.

Minimal collusion

Opportunity for fraud is extended by collusion. Specialist skills might be essential to commit a particular act or obtain access to premises or records. Collusion of this type usually applies to high manipulating fraud and will be limited to the smallest number of people absolutely necessary for fraud.

Maximum collusion

In this type of fraud, collusion takes place to the greatest extent possible so that all the employees are In the bout and united in a common criminal pursuit or purpose. This reduces the chances of detection and the risk of one employee giving information to another.

2. 2 TYPES OF BANK FRAUD

The following are types of bank fraud as observed by-Ovvkporie (1994): i. Suppression: Suppression of cash lodgment, cheques (especially clearing cheques) and documents of value such as direct debits, standing order etc. are other common types of fraud. It is usual among fraudulent staff to suppress third parties cheques drawn on their accounts when they have no sufficient funds to accommodate such drawings. Another form of suppression is that customer's surplus deposit which the reCe1VIng cashier or the note counters will intentionally refuse to state.

ii. Theft and embezzlement:

ii. Theft and embezzlement: This may well be in terms of monetary items such as cash, travelers cheques and foreign monies or in form of other bank property such as refrigerators, electrical equipment, air conditioners, motor vehicles, motor vehicle parts, computer equipment, beverages, toiletries, stationery etc. iii. Forgeries: This could be forgeries by customer's signature to draw money fraudulently from customer's account or forgeries of other employee's signatures for fraudulent transfer of funds from one account to another or for fraudulent withdrawal of funds from a customer's account. The forgeries may be targeted on savings accounts, deposit accounts, current accounts or transfer instruments such _as drafts, mail transfers, etc. Experience has shown that most forgeries are perpetrated by inside staffers or by outsiders in collusion with inside staffers who may have access to the specimen signatures being forged.

iv. Defalcation: Defalcation of customer's deposits either by conversion or fraudulent alteration of deposit vouchers by either the bank cashier or customer's agent is another form of fraud. Where the bank cashier and customer's representative collude to defalcate, such frauds are usually neatly perpetrated and take longer time to uncover. They are in most cases discovered by customers during reconciliation of their bank statement. Another variant of defalcation is stealing of some pieces of notes from wrappers by cashiers before wrappers are paid out to customers. v. Lending to ghost borrowers: Granting of l08. 11S and overdrafts to non-existing customers IS fraudulent, whether the ‘ ghost’ borrowers are repaying such loans or not. Experience has revealed that some corrupt bank managers grant banking facilities to themselves using fake names, signature and non customers as fronts.

vi. Fraudulent Substitution: Another disturbing type of fraud is fraudulent substitution of clearing cheques, bankers’ payment and other inter-bank - instruments. This type of fraud usually involves large sums. The substitution is in most cases done during the clearing process. Fraudulent substitution of clearing instruments is often syndicated in order to succeed. Members of the syndicate are usually stationed at the presenting bank, the central bank clearing house and the paying bank. They monitor the movement of the instrument to be substituted until their aim is achieved. Fraudulent substitution thrives where there are weak internal controls (checks and balances) and poor supervision.

vii. Impersonation: Impersonation by third parties to fraudulently obtain new cheque books which are consequently utilized to commit frauds is another dimension of bank frauds. However, cases of impersonation may not succeed if the passports photograph of the bonafide account holder is in place and referred to during the fraudulent transaction since the signature of the customer may be forged. viii. Kite flying and cross firing: Kite flying and cross firing of cheques by the customers with or without the collaboration of the branch manager is a fraudulent act. Kiting cheques is a term used to denote a method sometimes used by customers to make use of fictitious balance by drawing against uncollected fund. Kiting takes advantage of the time needed for cheques to be cleared and permits the kiter the use of funds that are not his.

It is usually practiced by a customer having two bank- accounts. By depositing a cheque drawn on bank ‘ A’ to the credit of his account in bank ‘ B’ and vice versa, a person may draw against fictitious balances thus credited, expecting to ‘ cover up’ before the cheques are presented. Cross firing on the other hand is a method used by a customer to create fictitious/ inflated account turnover. It is also practiced by a customer having two bank accounts ‘ A’ to the credit of his account ‘ B’ and vice versa, the customer would be able to inflate his/her account turnover over a period of time. ix. Payment against uncleared effects: Payment against uncol Jeered proceeds of cheques, drafts and other bills for collection is another type of fraud which is very common with branch managers and other credit officers.

When such instruments which have already been paid against by the presenting bank are eventually dishonored by the paying bank, and returned unpaid, the customer’s account will be debited with the sum already paid and the debt will crystallize. Experience has shown that most payments against uncleared effects are gratuitously made and as such it is difficult to recover such debt created. x. Foreign Exchange Malpractices: Forgery of foreign exchange documents, diversion of foreign exchange business proceeds, diversion of foreign exchange allocation to the black market using some ‘ ghost’ customers as fronts and other foreign exchange malpractices are fraudulent activities.

xi. Unauthorized Lending: Unauthorized lending, granting of banking facilities without security and verifiable accounting information is yet another form of fraud which is also rampant among credit officers and branch managers. Any lending that does not agree with laid down regulation of the bank or does not receive prior approval of line superior is fraudulent, whether lending is for only a few hours or for a longer period.

xii. Unofficial Borrowing: Borrowing from the vault and cashiers’ tills is a common type of fraud. Usually such unofficial borrowing are done in exchange of the staff post dated cheques or ‘ 1. 0. U’ or even nothing. Experience has shown that these borrowings are more prevalent on weekends i. e. Fridays and during the end of the month when salaries have not been paid. Some of the borrowing from the vault, which could run into thousands of Naira, are used for quick business lasting for a few hours or days after which the funds are replaced fraudulently. Aderibigbe (2005) also recognized the following as the common fraudulent practices: a. Forgery of document to support claims or expenses

b. Stealing of stocks and issuing of fictitious consumption vouchers to charge repairs and maintenance

c. Unauthorized pledging of security for loan

d. Charging of personal expenses to corporate expense.

e. Unauthorized credit to customers’ account to conceal receipt stolen

f. Falsification of records

g. Issuing of dud cheque to obtain cash

h. Teeming and lading

i. Debiting the bank account with cash receipt instead of teller receipt

j. Dummy names in payroll

k. Direct placing of cheque receipt to a special deposit account without putting the cheques through the normal clearing system. Fraudulent: In the case of banks the following are atypical: l. Over invoicing

m. m. Overvaluation of property given as collateral

n. Fictitious accounts

o. False declaration of cash shortages

p. Unauthorized lending

q. Fake payments

r. Lending to ghost borrowers

s. Interception of clearing cheques

t. Payment against uncleared effects

u. Duplication of cheque books, drafts and transfers v. Fictitious contracts v.

w. Substitution of cheques, drafts and transfers.

2. 3CAUSES OF FRAUDS

Experience has shown that frauds are usually perpetrated by either the operator alone, the customer alone, or even the non-customer alone or an amalgamation of any of them. In order to be able to recommend remedies for eliminating fraud in banks and other financial institutions, it is useful to classify the causes of fraud. Alashi (1994) has grouped the causes into

i. Institutional factors

ii. Environmental factors

Institutional factors:

These are those perceptible to the internal environment of the financial institution. They include: i. Banking experience of staff: All things being equal, fraud in financial institutions occur with higher frequency among staff with little experience and knowledge in financial practice. ii. Poor management: Financial institutions with weak management record higher occurrence of all sorts of fraud than those with efficient management. Poor management gives rise to ineffective and poor control systems, indiscipline among staff and therefore creates a situation for fraud to flourish. iii. Volume of work: The amount of work done by officials could be so heavy that fraud could easily pass unobserved by such officials. iv. Number of services: Fraud may be caused where documents of value and liquid assets are exposed to an undisciplined staffer illicit persons.

For example, customers. v. Number of staff: Where an official supervises quite a large number of staff, there IS a high possibility that fraud could go unnoticed. vi. Inadequate flack of staff training: This could affect morally weak as well as the morally robust staff in various ways. Lack of knowledge of the ways of dealing with fraudulent practices in financial instruments could affect an otherwise honest staff in apprehending and avoiding the tricks of finance instrument fraudsters. Other institutional factors consist of staff negligence, recruitment system, poor security arrangement for documents, use of sophisticated accounting machineries, frustration, inadequate infrastructure, delays in procuring documents, lapses in the management control system of corporate customers, negligence by customers.

Environmental factors:

These are those factors which result from the pressure of the environment or society on the banking industry. They include i. Lack of effective deterrent/punishment: Although, this may be considered as a controversial point, it is argued in some quarters that lack of efficient prevention such as grave penalty could be a factor that contributes to the un-abating perpetration of fraud in financial institutions. ii. Societal values: The value system in any society is the set of laws that stipulate what is right or wrong within the society. Where the ownership of wealth determines the status attributed to a person. That society is bound to witness pointless struggle for attainment of wealth. This undoubtedly will lead to some people using doubtful means to get rich quick.

It can be argued that the main origin of fraud in financial institutions in Nigeria is traceable to the general dishonesty in society where morality is thrown to the dogs. iii. Fear of negative publicity: Many financial institutions fail to report fraud cases to the authorities. They believe that doing so will give redundant pessimistic publicity to their institutions. This attitude encouraged individuals with excessive ambition to defraud in financial institutions. They reason acceptably that the affected institution may not accuse.

It is even sad to note that some staff whose appointment have been terminated or retired on grounds of fraud in one financial institution still manages to secure appointment in other institutions. iv. Personality profile or dramatist personal: Most individuals with extravagant ambitions without qualms are prone to committing frauds. This kind of individual is bent on making money by all means possible. Such people dismiss integrity as a pointless precondition for a moral life. To them, the end justifies the means; they are generally dodgy and opportunistic. v. Slow and indirect legal process: Delays in hearing of fraud cases have a way of provoking the parties to the case. A frustrated party can discard the case midway, leading to miscarriage of justice. The delays can be in form of: – Late reporting of cases to the police

– Lack of specialized manpower for the investigation of fraud – Frequent adjournment by the court, which could frustrate the appellant and favor the defendant – Lawyers and prosecution witness absenting themselves from court and; – Undue delay In the investigation and charging of cases to court. Aderibigbe (2005) In his research work identified the following as the general cause of frauds with their occurrence percentage. 1. Lack of internal control (27. 6%)

2. Absence of internal auditing activity (21. 9%)

3. Incompetence (2. 8%)

4. A single person having exclusive control of assets (15. 9%)

5. Deviation from laid-down procedures (20. 1 %)

6. No independence to internal auditor (3. 3%)

7. Other reasons (8. 4 %)

2. 4 EFFECTS OF FRAUD ON BANKS

There is no gain saying in the fact that out of all the problems facing the Nigerian banking industry today, that of fraud is the most exclusive and it has been having negative consequences on the customers, banks and the Nigerian economy. Some of these effects are:

i. Bank staff involvement: According to NDIC publication (1994) banks staff have been involving in fraud and this has led to termination of appointment, dismissal and suspension of many which would certainly affect their homes negatively. ii. The Distress Syndrome: Bank frauds continue to jeopardize the industrial growth as most banks have already gone under due to distress while some are still battling with distress syndrome. iii. Loss of Bank Funds: Liquidity state of the banks has always been hampered and huge amounts have been lost. iv. Fraud leads to unnecessary losses for the bank and puts the management of each institution on guard while expending hard earned resources, time and energy on fraud prevention.

v. Where huge amounts are involved, the reputation of the bank would be jeopardized and customers' confidence in the bank will be shaken. vi.

Unchecked fraudulent practices are not only capable of destroying a whole bank but can also destroy the economy of a nation. The incidence of fraud and other financial come in the banking industry and other financial institutions as a whole has negative effect on banks. It, consequently, calls for a serious look into it and managers of these banks seek ways out of the awful development. This research work looks into the role of internal audit function in the prevention and control of fraud in banks.

2. 5INTERNAL AUDIT FUNCTION

Aderibigbe (1997) defined internal audit as an in9. ependent appraisal activity within an organizational set for the review of operations and as a service to management. In his own view, Millichamp (1993) defined internal audit as an independent appraisal function established by the management of an organization for the review of the internal control system as a service to the organization. It independently examines, evaluates and reports on the competence of internal control as a contribution to the appropriate, economic, efficient and effective use of resources. According to the publication by the internal audit of Animal scare (1997), internal auditing is the continuous and systematic process of examining and reporting on the administrative systems and accounting methods of a company or group of companies.

It is carried out by the employees of the company and has its objectives: 1. The confirmation that policies of management are being properly executed and to draw attention to those areas where policies appear to be inadequate.

2. To verify that information used by management to control the unclear taking is both adequate and accurate. The scope and objectives of internal audit differ extensively and are reliant upon the responsibilities assigned to it by management, the size and structure of the enterprise, and the skills and experience of the internal auditors.

Normally, however, internal audit operates in one or more of the following broad areas. a. Review of the economy, efficiency and effectiveness of operations and of the functioning of non financial controls; b. Review of accounting systems and related internal controls; c. Review of the implementation of corporate policies, plans and procedures; d. Examination of financial and operating information for management, including detailed testing of transactions and balances; e. Special investigations.

2. 6FRAUD AND INTERNAL AUDIT

The most miserable of the duties of internal audit arises when cases of fraud or alleged fraud are being investigated. Fraud occurs when through an error of judgment, chance or oversight, people who are appointed to positions are temperamentally unsuited for them or who in time of stress become vulnerable to temptation open to them. (Smith et. al, 1969). It is therefore the responsibility of the internal auditor to see that circumstances do not exist in which a violation of trust is probable, otherwise carelessness in this respect makes it accountable in the eyes of all the persons who committed the fraud. To avoid such a situation, the internal audit staff is cautious to examine the administrative system and methods used, to ensure that the managers of the company have taken ample steps to check fraud or report rapidly and compulsorily any faults in the system which can promote defalcations. Internal audit shoulders the responsibility of assuring management through work done that assets are protected against all loss or theft by investigating the kind of insurance cover and that controls are in place and are working.

It is also the function of internal audit to appraise organizational policies and to advice management if any law of the land and other statutory requirements are being adhered to. It should, therefore, be understood that internal audit is an independent appraisal activity within the organization. It is an administrative control which functions by examining and evaluating the capability and efficacy of other controls. Management in most organizations seldom has the time to personally check that their plans and intentions are being complied with. The task is passed on to internal audit unit endowed with mandatory staff and experience to perform such work and keep management informed as to whether their plans are on or off course (Lubing D., 1991). Through the process of constant appraisal and effective monitoring of conformity with operating procedure, internal audit enhances, though circuitously, the productivity and effectiveness in the use of existing resources by all sections of the organization.

According to Millichamp (1993), the internal audit function IS to appraise the activities of others, not to perform a specific part of that data processing. For example, a person who spends his time checking employee expense claims is not performing an internal audit function. But an employee who spends time reviewing the system for checking employee expense claims may well be performing an internal audit function. The internal audit function will be aimed at ensuring that the management's requirements are met. The internal audit function can be seen as the eye of the board within the enterprise. Internal audit involves the assessment of operations and records undertaken within a business by specifically assigned staff.

The roles of the inspectorate division are to serve as a watch-dog on bank funds and property; to ensure that there is no inappropriate application of funds; to make sure that expenditure and revenue are duly approved and accounted for; to occasionally examine account books in order to make certain that transactions are correctly recorded and books are regularly balanced; and to investigate malpractices like fraud, forgeries and theft of bank assets. For utmost effectiveness, the internal audit unit of banks should have direct access and liberty to report to senior management, including the chief executive, the board of directors and where necessary, the board's audit committee.

2. 7FRAUD PREVENTION

Two extensive preventive measures may be identified. One is general and the other specific. General measures involve a summary of the major characteristics of fraud, review of management control systems to spot weaknesses that fraudsters can manipulate, prescribing measures to correct the defects or weaknesses and strengthening the strong point, and appreciating the need for assigning responsibilities. Specific measures relate to specific modalities that address strategic sections within the general measures that should be taken and assigning responsibilities accordingly (Nwankwo, 1991).

2. 7. 1General Measures

When creating the general preventive measures, the bank should understand the major characteristics of fraud. One is that fraud is a rapidly expanding and very lucrative industry and that the computer technology facilitates and accelerates the growth. Other features are that, fraud involves misuse of assets and manipulation or alteration of data and that most frauds result from basic failures and inadequacy in internal controls. From the above, management should develop positive policies towards safeguarding the banks' assets and ensuring that staff do not take advantage of weaknesses in internal control. The policy should stress the basic principles of separation of duties to make sure that one person does not initiate and complete an assignment or entry.

The responsibilities of the board of directors should also be clearly spelt out and properly explained to them. Usually, these include directly the overall policy and management of the bank fiduciary duty to act honestly and with utmost good faith, and the exercise of skill and care in discharging the statutory obligations of the bank. Particularly, the Board has the joint responsibility to the members to make sure that appropriate security systems exist, there are satisfactory accounting records and internal control measures, and that there are adequate safety measures to prevent falsification of accounting records and assist the discovery of any falsifications.

2. 7. 2 Specific Preventive Measures

Having specified and assigned responsibilities for general preventive measures, specific preventive measures should be evolved to tackle particular sensitive sections of the bank's operations. Preventive measures should begin from the design of the system to the paraphernalia of protecting it, including a back-up system to allow for machine failure, cryptographic facilities to protect the computers, data network and terminals from illegal access or tampering or protection services to prevent attackers denying access to legal users. Other areas include the payment process, key management, recovery and contingency arrangements, software and data integrity and security responsibilities. Each message must be validated end-end with the appropriate keys which must be properly protected. Power outage must be guarded against by providing constant power supply through standby generators.

2. 8ELEMENTS OF FRAUD AUDITING

The following are some elements of fraud auditing:

Detection: The fraud audit itself is the preliminary, usually clandestine, state designed to establish the areas of a business in which fraud is likely; to separate fraud symptoms and to recognize the suspected perpetrators. Where no symptoms of fraud appear, the decision may be to discard the exercise at this stage. As much of the work performed will be of a statistical nature and is essentially incidental, it may sometimes be met with disbelief or doubt by line management. It follows from this that the techniques used in the detection phase should be classified, and incidental evidence should not be used in any successive legal action. Investigation: This state is designed to resolve the fraud symptoms or suspicions so that they can either be dismissed or acted upon. It may include undercover surveillance and investigation, detailed examination of records, and interviewing witnesses and suspects.

Action: The ensuing action may be internal to the organization or external or a blend of both. The choice will depend upon circumstances and is very much an issue for the individual organization. Internal action can vary from improving systems to avoid a reoccurrence, through normal disciplinary procedures, to dismissal. External action would include criminal prosecution and also civil action for compensation. Publicity: Publicity is the final key element and may be achieved informally by means of the “ grapevine” or formally through direct briefing of employees, house journals, or local, national or trade press. Care must be taken that publicity does not prejudice any legal action. Monitoring: A successful anti-fraud operation will result m reduced fraud in the organization, through both the abolition of the fraudsters and the spin-off-effects of publicity. The result is to create, at least momentarily, a fraud-free period which should reveal the factual performance of the operation. This can then be used as a starting point ‘ to determine subsequent underperformance or fraud.

2. 9MEASURES OF CONTROLLING FRAUD IN BANKS

Ebhodoghe (1997) emphasizes in his book, " Safe and sound banking practices in Nigeria", that the constitutional requirement for banks to employ external auditors to check their books and affairs should be compulsory. Also, the suitable and efficient utilization of the internal audit unit of banks should be emphasized. Ovuakporie (1994) recognized that in order to minimize or probably reduce the rate of fraud in banks, there are some precautionary and preventive measures that must be put in place. These measures may not essentially be adequate depending on the situation; management could use their initiative and understanding of local environment as appropriate to expand these recommended measures. These measures include: i. Strict adherence to operational manual: The operational guidelines should be consistently adhered to when a transaction is being undertaken. All the various steps specified in the manual should be thoroughly followed from the beginning to the end to each transaction as appropriate.

ii. Effective Internal Control: All staff must make sure that all internal control measures put in place are observed. Such measures as authentication of customer's signature by two autonomous approved officials, dual control over cash and other bank assets, regular snap checks, close supervision of subordinates etc, should be observed at all times. iii. Good Management: The management should exhibit good leadership traits and should also have a firm grasp of the job and effective control over the entire staff. The management should also have high level of technical and theoretical capability, sound judgment and exercise adequate supervision over all aspects of bank's operations. There should be appropriate planning and organization and the management should display ideal leadership and transparent honesty. iv. Periodic and Regular Audit: The audit function which should serve as an efficient means of months to one year. The inspectors/ auditors must be qualified bankers versed in book-keeping practice and banking operations generally. v. Training: There should be adequate training and retraining for both management and other staff. Staff should be given sufficient technical and theoretical training about the various tasks to be performed.

vi. Daily Audit: There should be daily examination of all the entries/operated accounts by responsible officials. These officials should ensure that cheques and other items were not duplicated, that the correct amount was keyed in to the ledger and that all other particulars such as authorizing power, cheque number, account number etc. are key in every respect. As the last check, the importance of daily audit cannot be over emphasized. vii. Good Personnel policies: Both recruitment and selection policies should highlight merit and be comprehensive enough to identify bad eggs right from the start and dispense with them immediately. There must be an appropriate career development plan for each staff while compensation i. e. salaries, wages and staff welfare should generally be sufficient to meet at least the physiological and social needs of the employee.

There should be frequent interaction between management and other staff to harmonize areas of conflict between individuals and the organizational goals. viii. Snap Checks: A detailed surprise check over all aspects of the bank operations, as well as its assets and liabilities, should be carried out at regular intervals; say once every month. The spot check should be wide-ranging both with respect to the date as well as to the officials checking the various items. ix. Proper Book-keeping: Proper books of account and other additional records must be maintained. Bank management must make sure that the books are balanced on a daily, weekly, monthly or quarterly basis as appropriate, while differences should be carefully investigated until they are determined. Other measures include:

a. Discipline

b. Scrutiny of cheques present

c. Constant monitoring of accounts

d. References on savings accounts customers depositing negotiable instruments

e. Statement dispatch

f. Security

g. Proper account opening procedure

h. Verification of customer’s signature on large cheque and other instructions

i. Job segregation

j. Dormant protection

k. Dual control

l. Reward/protection of any member who gives information on fraudulent people

m. Provision of Regis cope camera

n. Annual leave

o. Adequate knowledge of individual staff

p. Control over issuance of cheque books

q. Daily balance reconciliation

r. Job rotation

s. Provision of close circuit T. V.

2. 10 STATEMENT OF INTERNAL AUDIT STANDARDS NO 3

SIAS 3 is about prevention, detection, investigation and reporting of fraud. The statement sheds light on the role of the internal auditor in relation to the detection, prevention and control of fraud. The internal audit responsibilities of preventing, detecting, investigating and reporting of fraud have been a matter of much discusses and controversy. Some of the controversy can be credited to the differences in the charter of internal auditing from country to country and from organization to organization.

Another reason for the controversy may be idealistic expectations of the internal auditor's ability to prevent and detect fraud. The level of the internal audit function should include the assessment and appraisal of the capability and the efficiency of the organization's system of internal control and the quality of performance in carrying out assigned responsibilities. Internal auditors should assess the means used to safeguard assets from various types of losses such as those resulting from theft, fire, inappropriate or illegitimate activities, and exposure to the elements.

2. 10. 1Deterrence of Fraud

Deterrence consists of those actions taken to discourage the perpetration of fraud and limit the exposure if fraud does occur. The most important method of preventing fraud is control. The major responsibility for establishing and maintaining control rests with management (SIAS 1).

CHAPTER THREE

RESEARCH METHODOLOGY

This chapter deals with the various methods used to collect data. ' Also, it spells out the techniques used to evaluate the data collected from various sources.

3. 1AREA OF STUDY

Equitorial Trust Bank Limited was incorporated as a private limited liability company on 30th January 1990. It was granted banking license to carry out commercial banking business on 7 February 1990 and commenced operations on 1 March 1990. The bank's head office is located at Plot 1092, Adeola Odeku Street, Victoria Island, Lagos. The bank has 45 branches in Lagos, Ogun, Oyo, Osun, Ekiti and Kwara states among others.

3. 2RESEARCH DESIGN

The research design employed for this study is a descriptive survey type that employed an ex-post facto in which the researcher does not have direct control of the independent variables because their manifestations have already occurred or because they are not inherently manipulable. According to Hassan, the design attempts to provide an accelerate description or a picture of a particular situation or a phenomenon at one or more points in time. Similarly, Best (1981) noted that the approach enables a researcher to obtain information from a representative sample of a population in order to describe the situation as they exist from where the researcher could infer the perception of the entire population. The study was a systematic empirical enquiry in which the researcher does not have direct control over conditions influencing the subjects' choice decision. In other words, the manifestations had already occurred and were not manipulated by the observer.

3. 3METHOD OF INVESTIGATION

The population of this research was made up of all banks present in Nigeria. For the purpose of this research, there is a limit to the case study. Presently there are about 25 banks in Nigeria. The case study is equatorial Trust Bank Ltd, Victoria Island, Lagos State. The bank will serve as our sample. The researcher went to the headquarter of the bank at Victoria island to gathers some information about their internal audit system and to collect relevant data necessary for the analysis of this study.

3. 4SAMPLING TECHNIQUE

The methods used to draw out respondents were the stratified and random sampling techniques. The staffs were first stratified into departments, which gave us four departments. A simple random sampling technique was then used to select respondents from each department. A total of thirty respondents were then selected from each stratum in each of the departments. In this way each group in the population was represented. The combination of these sub-samples from all the strata in all the departments constituted the sample size for this study. In all, 120 staffs constituted the sample for this study out of which 30% were female, while the remaining 70% were male respondents respectively.

3. 6RESEARCH INSTRUMENT

Fraud is an occurrence which has a negative impact on the bank and its customers. Hardly can we have a single branch of a bank in Nigeria where fraud is not perpetrated. Nevertheless, banks are reluctant in providing information on the occurrence of fraud in their banks. This may be as a result of fear of breakage in their competitive strength with other banks. Thus, data was collected from secondary sources also with the aid of the Central Bank of Nigeria’s report and also the annual report of Equitorial Trust Bank.

3. 6MEASUREMENT OF VARIABLES

A variable is a characteristic which may take on different values. For example weight, sex and age are variables. A variable is a quantity which a researcher is interested in that varies in the course of the research and has different values for different samples in the study. There are two types of variables, dependent variable and independent variable.

3. 6. 1 Dependent Variable

A dependent variable is the quantity that assumes different states and it is the unit the researcher is highly interested. For the purpose of this study the dependent variable was the fraud prevention under consideration and was measured using as-point likert scale and ratio scale. 3. 6. 2 Independent Variable

It does not vary or depend on others. It is that variables whose effect upon the dependent variables we are trying to understand or study. The independent variable was internal audit system of the bank.

3. 7DATA ANALYSIS TECHNIQUE

Owing to the nature of the presenting data collected the Chi Square analytical tool was used to determine the degree of association in cross tabular data. It is used to determine how to observe phenomenon deviated from the expected from the expected. The Chi Square (x2) is general tool designed to evaluate whether the difference between observed value and expected value under hypothesis could be attributed to sampling fluctuation or to non change factors. [pic]

Where

X2 = Chi Square value

O = the observed frequency

E = the expected frequency

Σ = Summation of respective values.

The decision rule will be computed with the Chi Square value based on sample data if this value exceeds central value of the Chi Square determined as a confidence level of 95% and of appropriate degree of freedom. The null hypothesis would be rejected and in its place the alternative hypothesis will be accepted. CHAPTER FOUR

DATA PRESENTATION, ANALYSIS AND INTERPRETATION

4. 1INTRODUCTION

Data gathered through various means are not meaningful until carefully analyzed and interpreted to give useful information. Thus, this chapter deals with the presentation, analysis and interpretation of data gathered from the secondary sources. The data were collected from the Central Bank's annual report on banks and was analyzed using percentages.

4. 2ANALYSIS OF THE SECONDARY DATA

From the reports of various banks in Nigeria submitted to the Central Bank of Nigeria, as found in the Annual Reports and statements of Accounts of the Central Bank of Nigeria, the amount involved in fraud cases and bank staff involved were given with their percentages. TABLE

| BANK STAFF | 2003 | | 2004 | | 2005 | | | | Number |% | Number |% | Number |% | | Supervisor & managers | 178 | 30 | 132 | 27 | 55 | 36 | | Ex. Assistants, Accounts officers | 144 | 24 | 101 | 20 | 60 | 40 | | Clerks & cashiers | 92 | 15 | 137 | 28 | 30 | 20 | | Messenger, Driver, Cleaners, security guards & stewards | 127 | 21 | 81 | 16 | 5 | 3 | | Temporary Staff | 3 | 1 | 14 | 3 |- |- |

Source: Annual Report and statements of Accounts of CBN (2006) From the above table, it is observed that bank staffs are also involved in fraud and forgeries within their various banks. The staff ranges from the supervisors and managers to temporary staff. In 1999, supervisors and managers constituted 30% of the total staff who were involved in fraud and forgeries in the banks, followed by officers, Ex. Assistants and accountants with 24%. This depicts a clear picture of the situation within the banks. The top officers with greater responsibilities towards prevention and control of fraud and forgeries and other irregularities within the various banks constitute the largest proportion of bank staff involved in fraud and forgeries. These top rank officials are those who make and ensure the implementation of the strategic policies of their banks like putting in place a proper internal control system.

They are the ones who appoint internal auditors and set up a proper internal audit function to see to the compliance of the internal control system of their banks and also the evaluation of the whole system of control financial and otherwise of the banks. There is no gain say in the fact that these top officials of the banks determine, to a greater extent, the effectiveness and efficiency of the internal audit function. They are able to influence the audit unit of their banks to their own taste and desire.

Other bank staffs who are involved in fraud and forgeries include clerks, cashiers, messengers, drivers, cleaners, security guards and stewards. In 2000, supervisors, managers, officers, ex-Assistants and Accountants constituted 47% while in 2001 it was 76%. In compliance with the requirements of section 39 and 40 of NDIC Decree No 22 of 1988 as amended (Nigerian Deposit Insurance Corporation), banks render monthly returns on frauds and forgeries and also notify the ' Nigerian Deposit Insurance Corporation about termination and dismissals of staff. Analysis of the type of fraud and forgery cases perpetrated showed that the most common types are the following: (a)Presentation of forged cheques

(b)Posting of fictitious credits

(c)Fraudulent transfers and withdrawals

(d)Granting overdraft

(e)Unauthorized overdraft

The above types of fraud and forgery cases occur within the operating environment of a bank involving the bank officials. The availability of an efficient and effective internal audit unit can prevent or at least minimize the occurrence of such events. The role of the inspectorate unit or internal audit is to serve as a watchdog on bank funds and property. This is not so because those who are expected to perform such roles are doing so, but due to influence from superior bank officials, their efforts are being suppressed.

CHAPTER FIVE

5. 0SUMMARY, CONCLUSION AND RECOMMENDATIONS

This chapter gives a rundown of all that has been done so far in this project. Conclusions were also reached from the analysis and interpretations made in the previous chapter. Recommendations are given as a contribution to the research work. The banking industry in Nigeria has recently drawn a greater attention to itself by all units of the economy-government, firms and households. This is as a result of the important role it plays in the growth and development of the economy. Government recently had several regulations put in place within the financial institutions of the nation. A good example is the N25 billion minimum capital base for all banks in Nigeria, the ban on merging accounts on the Nigeria Stock Exchange (NSE) and the uniform financial calendar. There has recently been a panic wave within the banking industry in Nigeria, which has affected the economy adversely, resulting to loss of millions of Naira by firms, individuals and government parastatals. One of the serious causes of this situation in the banking industry is fraud. Fraud in various dimensions has led to the inefficiency of majority of the banks in Nigeria today.

This development has therefore called for an internal appraisal of the various controls and prevention strategies put in place by banks in Nigeria against the occurrence of fraud in their banks. One of the controls put in place is the presence of an internal audit unit in their banks. This unit is to act as a watchdog over the banks financial and non-financial resources. This research work therefore appraises the internal audit function in the prevention and control of fraud in banks.

Fraud is a business risk, which poses a threat to the banking industry in Nigeria today. It is a social vice that is connected with dishonesty, deception and deliberate attempt to benefit at the expense of others through illegal means. The possibility of fraud arising, and the extent of its impact, should be part of the periodic corporate risk assessment process undertaken by the board when it reviews its strategies. Internal auditors have a major role to play in this process in providing stakeholders with assurance that this high level process is undertaken with sufficient regularity and the right degree of robustness. Internal auditing can make a significant contribution to fraud prevention by undertaking its primary role of providing management with

(1)opinions on internal control effectiveness

(2)recommendations for control improvement and

(3)information on leading-edge techniques for fraud detection and risk assessment.

5. 2CONCLUSION

In-house auditors play an important role because they are the ones who should be able to provide the banks with a good defense mechanism, to guard against possible fraud and malpractice. They must function actively to identify weaknesses in the control systems, look out vigilantly for internal fraudsters and alert the top management of any malpractices uncovered. To facilitate effective functioning of auditors, banks should devote adequate resources, both financial and operational, for the proper conduct of their businesses.

Furthermore, auditors’ independent status should be respected, and in any case, must not be compromised by the line management concerned. For sound understanding and vivid comprehension of this research, further conclusions have been reached as follows: i. All banks are expected to have inspectorate/audit unit staffed with professionals in auditing. ii. Inspection takes place within banks in Nigeria at least once a year. iii. The internal audits of banks in Nigeria were created as a result of company policy, financial regulations or banking ethics. iv. Irregularities are reported often in banks of Nigeria.

v. The performance of workers in the audit unit cannot be judged totally satisfactory. vi. The internal auditors are preoccupied with their primary duty of auditing. Thus, they are independent of the activities they audit. vii. Staffs are recruited to the unit basically based on past experience. viii. It is the duty of management to enforce the compliance of their banks with their internal control system. ix. Internal auditors can prevent and control fraud if they are allowed to operate in accordance with the ethics of the profession.

5. 3RECOMMENDATIONS

The banking industry is a very sensitive sector in any nation. It has a direct linkage with the growth and development of any economy. Thus, all hands must be on deck to find a lasting solution to the problems of fraud in Nigeria. Internal audit units are part of the internal control device for controlling irregularities within a bank. The following are recommendations:

i. The Central bank of Nigeria should enforce the independence of internal audit unit from the control of management in the aspect of controlling and prevention of irregularities within banks. ii. Every bank should enhance its internal audit unit or inspectorate unit with qualified auditors and accountants who will be able to perform the task expected of them according to the rule and ethics of the profession. iii. Training and developmental programs should be organized for the employees in the audit unit in order to equip them with both manual and sophisticated methods of detecting, preventing and controlling fraud in banks. Other methods that can be recommended for preventing and controlling fraud in banks are: (a)Personnel Control: These include the establishment of proper procedures, enforcement of proper release notice, compulsory annual servants' vacation to enable a new hand in operation, etc.

(b)Financial Control: These include an adequate procedure for signature verification, authentication and approval, establishment of cash limit in the vault or with the cashier per unit of time, establishment and strict compliance with approval limit, establishment of limit to the signing power on security document. (c)Process Control: These include input and output validation through the use of security cards, the maintenance of strict control over the amendment of computer program, restriction of access to the computer room to only authorized personnel, maintenance of movement register over computer files, diskettes and other electronic carriage storage devices.

(d)Accounting Control: These include validation of all entries by the process of call over and prompt check, timely reconciliation of books and inter branch current account, ensuring that adequate documentation are maintained for all transactions. (e)Inventory Control: These include the maintenance of movement register for all assets and materials, ensuring of adequate recording and documentation of all physical assets and materials, routine and unannounced physical checks on bank property at regular intervals. (f)Administrative Control: These include proper speculation of duty such that there is no single person who dominates the processes of initiating and completing a transaction, dual custody and control of cheque and bank balances. (g)The Nigerian Deposit and Insurance Commission (NDIC) should put in more effort in the area of supervision of banks.

5. 4SUGGESTION FOR FURTHER STUDIES

This research is on the appraisal of the internal audit function in fraud prevention and control in banks. This may not be the entire story. For this reason, it is therefore suggested that further researches be carried out using other variables and parameters.

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