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DEVELOPING INSTITUTIONAL CAPACITY IN TACKLING THE PROBLEM OF RISKS AND FRAUDS IN FINANCIAL INSTITUTIONS IN NIGERIA

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ABSTRACT

This paper examines the effects of the twin problems of Risk and Fraud on the sustainability of financial Institutions in Nigeria. Financial Institutions by their nature of businesses are daily prone to the issues of risk and fraud. The role of financial intermediation exposes them to various degrees of uncertainties and unethical practices by employees at different levels. Risks and fraudulent practices have continued to wreck colossal damages on the financial sector of the economy. The emergence and introduction of Information Computer Technology have in fact widened the dimension and scope of exposures being experienced these organisations. Incidentally, the complicity of management in fraudulent practices has incapacitated this vital organ in effectively tackling or curtailing the challenges posed by risks and frauds. As the financial sector is crucial to the economy, there is urgent need to address the dangers posed by these problems. Empirical evidence shows that management, staff at all levels have being affected with the corrupting influence of frauds while the issue of business risks have not been comprehensively addressed by relevant organs saddled with such duties so as protect the assets of the companies. This paper therefore recommends that, one; Enterprise risk management framework should be embraced and promoted by all financial institutions to safeguard the assets of their organizations. Two, there is the necessity of attitudinal change by all stakeholders particularly the internal customers. Three institutional cultures of integrity, honesty, justice, fidelity, equity and transparency must be institutionalized as control measures against fraudulent practices.

KEYWORDS; *Risk, Fraud, Fraudulent practices, exposures*

INTRODUCTION

Most of the incidences of bank failures or financial distresses being experienced in the financial service sector could arguably be ascribed to the problem of poor risk management and or unmitigated fraudulent practices within those institutions. The nature of their business activities of financial intermediation, taking deposits and dispensing loans have equally make them to be more open to risks and fraudulent activities. The occurrence of risk have continued to deplete the assets and caused financial losses. Despite the compulsory deposit insurance scheme for all deposit taking institutions, this has not reduce the increasing rate of financial losses through risks and frauds in financial and non financial institutions. In fact the uniform insurance premium paid by all Deposits

Money Banks whether you are a high risk taking Bank or a moderately risk taking bank, seems to serve as an incentive for risk lovers to take more risks.

Risk is the possibility of a loss occurring. The loss could be financial loss or material or loss of goodwill. It is the chance of the unwanted occurring

Risk indicates possibility of occurrence of action or event that results in any loss which reduces the possibility of achievement of institutional goals.

Fraud is one of the major factors responsible for the failure of most business enterprises in the world today. It is also the cause of failures of government policies and programmes. Fraud is a criminal offence in which a person acts in a deceitful way. Fraud is the use of one's occupation for personal enrichment through deliberate misuse or misapplication of employing organisation's resources and assets for personal gains. Empirical evidences have revealed the involvement of both Management and Employees in fraudulent practices that have continued to undermine the survival and sustenance of such institutions for a long term basis. "Statistics about how much fraud is occurring are difficult to get. However, all signs indicate that fraud is increasing both in frequency and volume (amount). Fraud is very costly to organisations and to economies. Because fraud reduces net income, the amount of additional revenue needed to restore the stolen funds is in many multiples of the amounts of the fund." (Albrecht W S et al 2012). Peter Goldmann (2009) in the book titled -Anti –Fraud Risk and control Workbook made the following revelations;

- Organisations lose an average of 7 percent of gross revenue to fraud every year.
- It takes an average of 24 months for a fraud to be detected
- The most common method by which fraud is detected is tips. Over 46 percent of cases that are detected are reported via a tip from an employee, vendor, or other whistle –blowers.
- Fraudulent financial reporting, the main form of management fraud is twice as common in organisations as billing schemes the most common form of employee level fraud.
- 74 percent of employees report that they have observed or have firsthand knowledge of wrongdoing in their organisations in the past 12 months
- The money common type of fraud affecting institutions by far is theft of assets which can include money, services or physical assets
- Organisations that implement entity wide fraud awareness training cut fraud losses by 52 percent.
- One third of large organisation executives say they have no documented investigative policies or procedures for fraud , and one half have no incident response plan

STATEMENT OF PROBLEM

Financial Institutions are prone to heavy losses as a results of exposure (risks) daily experienced due to their nature of operations and unmitigated fraudulent practices by both management and employees even in midst of internal control systems and good corporate governance.

OBJECTIVE OF STUDY

The objective of the study is to evaluate the effects of risks associated with various degrees of businesses and fraudulent practices, on the sustainability of an organisation in particular and the economy in general. The findings would be immense benefits to stakeholders of financial institutions as well as regulators and policy makers.

LITERATURE AND THEORETICAL CONCEPT

Risk

Generally there are different definitions for the term Risk , as Bankers, Economists, Accountants , Social Scientist, Risk specialist tend to give varied meanings to the word , depending on their viewing angle. Risk can be described as the probability of incurring a loss or the possibility of the undesirable occurring alternatively it is the failure or the desirable not occurring. Business risk would often results into material or financial losses if unmitigated.

It should be noted that both financial and non financial institutions are daily confronted with different types of risk in their business activities. Financial Institutions are faced with the risks like, market risk, credit risk, liquidity risk, operational risk, regulatory risk , currency risk, environmental/political risk to mention but a few. The nonfinancial institutions risks include business risk, operational risk, market risk, credit risk, sales revenue risk, operating cost risk, and environmental /political risk. Financial intermediaries face a number of risks owing to the type of business they transact. Their function of intermediation is a source of many of these risks.(Sharma M 2012). Sharma categorized the risks faced by financial intermediaries into asset-liability generated risks, portfolio risks, operational risks, and solvency risks.

Ezike E J (2002) defines risk as deviations from expectations. It is a failed expectation or occurrence of the unexpected.

Risk, according to Nwankwo G.O (2004) is the possibility of loss, injury, damage or peril, is inevitable in life. No aspect of human endeavour is devoid of or can escape it. It is inherent in everyday life and more so in the life of a banker. His business has been and continues to be taking risks. This he does through maturity transformation-borrowing short and lending long. The foundation for doing this is the probability that he will not be called upon at any one time to redeem all his obligations, provided he manages his affairs prudently. This implies having adequate capital and earnings and adequate liquidity to honour his obligations as they fall due. It also means avoiding excessive risks. He cannot avoid risks altogether. He will be out of business if he tries to do so. The risks he takes must be compatible with profitability, liquidity, and prudence. Managing risks, is like managing capital and liquidity of the bank therefore the central focus of banking is risk management as this fundamental to the sustainability of the institution. Banking risks can be categorized into two broad groups namely fraud risks and market risks. Fraud is deliberate deception, trickery or cheating for unlawful gain or unjust advantage such as outright thefts, defalcations and embezzlements. Market risks are exposures in bank operations in the market place that subject the bank to the prospect of loss and hence to the weakening of capital resources like confidence risk, liquidity risk, fraud risk, credit risk, interest risk, earnings/profit risk, operations risk, investment risk,

currency /foreign exchange risk, funding risk, counterparty risk, country risk, sovereign risk, insured risks, regulatory risks and off balance sheet risk.

Anthony T, and Deborah C, (2011) define risk as the possibility of a loss or an injury created by an activity or a person. It also states that a risk could be a probability or the chance of making an incorrect decision. To Harrington S and Niehaus G (2004) risk is used to describe the variability around the expected value and at other time to describe the expected losses. Business risk is concerned with the possible of reductions in business value such as price risk, credit risk and pure risk (theft, embezzlements, litigation losses, workplace injuries, etc)

Vaughan E,J, Vaughan T, (2008) explain risk as a condition in which there is a possibility of an adverse deviation from a desired outcome that is expected or hopeful for. In other words risk deals with the uncertainty of an event or the possibility of the expected not occurring. In further expatiating Vaughan et al made a distinction between fundamental and particular risks. Fundamental risks involve losses that are impersonal in origin and consequence that are caused partly by economic, social and political phenomena, they may result from physical occurrences. Particular risks involve losses that arise out of individual events and are felt by individuals rather than by the entire group or community. There is also distinction between Pure and Speculative risks. While speculative risk describes a situation in which there is a possibility of loss but also a possibility of gain. On the other hand , Pure risk is a situation of only a chance of loss or no loss. Pure risks that affect both individuals and business firms include personal risks, property risks, liability risks, and others. Enterprise risk management attempts to integrate the management of all of the firm's risks both pure and speculative. Enterprise risk consists of market risk, credit risk, liquidity risk, operational risk, reputational risk, strategic risk, and compliance risk.

Owualah posited that the issue of risk in bank management is multifaceted and can be classified into traditional risks and nontraditional risks. The traditional risks include, credit risk/asset risk/ default risk, liquidity risk, operating risk, maturity risk/interest risk/investment risk, and currency risk/transfer risk. While the nontraditional risks are Sovereign risk/political risk, and country/economic risk.

FRAUD

Fraud has been described as the number one enemy of the business world as no organisation or corporation is immune to it. It is highly cancerous and has caused the failure and collapse of many corporate entities including government institutions. Fraud has resulted in the largest losses to depositors and other creditors including deposit insurance agencies. They are rampant, pervasive, and the largest single cause of bank failures.

There seems to be a definitional problem of fraud in giving appropriate meaning to this word fraud, as there have been varied explanations to the fraud. As Peter Goldmann collaborated this assertion that most people involved in the fraud –fighting business have their own concept of what fraud is or what fraud isn't. Some definitions are legal, others are academic, while others are based on personal experiences. To Goldmann fraud is theft and deception or White –Collar crime. "Fraud occurs when a person in a position of trust and responsibility, in defiance of prescribed norms, breaks the rules to advance his personal interests at the expense of the public interest he has been entrusted to guard and promote". Furthermore, Goldmann categorized fraud into two namely Management fraud and Employee fraud.

Management fraud includes,

- financial statement fraud,
- illegal financial transactions,
- embezzlement or theft,
- concealing material facts,
- giving or accepting bribes,
- travel and entertainments fraud,
- accounts payables fraud,
- Misuse of company's assets etc.

While Employee related frauds are,

- embezzlement,
- theft,
- kickbacks,
- payroll fraud,
- cheque fraud,
- accounts payable.

In any system or organisation there are **signals or fraud indicators** that would normally show the existence of fraudulent practices. Such fraud signs are weak sense of ethics, risk taking propensity, refusal to take time off of duty, coming in early or staying late at work, abuse of drugs or alcohol, sudden or unusual mood swings, showing up at work with possession beyond their financial means among others.

There are also red flags for management level fraud such as;

- Management places excessive emphasis on meeting financial performance or budget goals.
- Management becoming hostile towards or intimidates auditors in defense of aggressive accounting practices that misrepresent the organisation's financial condition
- Management vocally expressing disappointment for regulatory agencies and standards
- Long term vendors are suddenly changed
- Prices of goods and services suddenly jump
- Bank statements shows sign of alteration
- Blank cheques missing
- Booking business trips for personal use
- Resubmitting the same expense reimbursement claims
- Personal expenses are charged to organisation's account
- Submitting photocopies of receipts instead of originals

Albrecht W S et al (2012) explains fraud to involve all deceptive ways in which one individual obtains an advantage over another by false representations. Fraud always involves confidence and trickery. Fraud is different than robbery where force is used. The following types of frauds were identified namely

1. Employee embezzlement - Employees use their positions to take or divert assets belonging to their employer. This is the most common type of fraud
2. Vendor Fraud – Vendors either overbill or provide lower quality or fewer goods than agreed
3. Customer fraud – Customers don't pay , pay too little or get too much from the organisation through deception
4. Management Fraud – Management manipulates the financial statements to make the company look better than it is. This is the most expensive type of fraud
5. Investments scam – These types of frauds are committed on the internet and in person and obtain the confidence of individuals to get them invest in worthless schemes.
6. Other types of fraud – Anytime anyone takes advantage of the confidence of another person to deceive him or her.

Fraud symptoms can be grouped into 6 groups (Albrecht W S et al 2012) as shown below;

1. Accounting Anomalies

- Irregularities in source documents
- Faulty journal entries
- Inaccuracies in ledger
- Stale items on bank reconciliation
- Missing documents
- Alteration on documents
- Duplicate payments
- Excessive voids or credits
- Increased past due accounts

2. Internal control weaknesses

- Lack of segregation of duties
- Lack of physical safeguards
- Lack of independent checks
- Lack of proper authorization
- Lack of proper documents and records
- Overriding of existing controls
- Inadequate accounting system

3. Analytical fraud systems

- Unexplained inventory shortages or adjustments
- Deviations from specifications
- Increased scrap
- Excess purchases
- Too many debit and credit memos
- Significant increase or decreases in account balances, ratios or relationships
- Physical abnormalities
- Cash shortages or overages
- Excessive late charges
- Unreasonable expenses or reimbursements
- Excessive turnover of executive staff
- Strange financial statement relationships

4. Extravagant lifestyles

- Purchases of expensive houses, jewelries, cars
- Moving into an expensive homes or houses
- Taking vacation outside the country
- Spending more money on food and flamboyant lifestyle

5. Unusual behavior

- Insomnia
- Increased drinking
- Taking drugs
- Unusual irritability or suspiciousness
- Inability to relax
- Lack of pleasure in things usually enjoyed
- Fear of getting caught
- Inability to look people in the eyes
- Showing embarrassment around friends, co workers , family
- Defensiveness or argumentativeness
- Unusual belligerence in stating opinions

- Confessing to a religious leader or psychologist or other professional colleagues
- Obsessively contemplating possible consequences
- Thinking of excuses and finding scapegoat
- Working standing up
- Sweating
- Increased smoking

6. Tips and complaints

- Anonymous complaints about buyer or vendor
- Unsuccessful vendor complaints
- Quality complaints about purchased products

According to Anthony T, et al (2011), financial crimes are defined as crimes against property involving the unlawful conversion of property belonging to another to one's own personal use and benefit. Financial crimes often involves fraud such as cheque/credit card fraud, mortgage fraud, corporate fraud, bank act fraud, bank robbery, kickbacks, embezzlement, tax violations, insider trading , identity theft, cyber attacks, money laundering , burglary , currency fraud. Fraud is could be defined as deliberate deception designed for gain by hurting another person's interests. Fraud occurs when a person in position of trust and responsibility, in defiance of prescribed norms , breaking the rules to advance his personal interests at the expense of the public interest he has been entrusted to guard and promote. It occurs when a person through deceit, trick, or highly intelligent cunning gains an advantage he could not otherwise have gained through lawful just or normal processes.

Fraud is an aspect corruption. Kana, A.A (2014) defines Corruption as the violation of a legal duty due to material inducements to do so. It is the giving and taking of bribes to carry out an official duty or to violate such a duty. It comes in varied forms but the most common are bribery, undue influence, abuse of office, impersonation, cheating and fraudulent misrepresentation as well as the outright theft of public property. Corruption involves cutting corners and the unlawful diversion of a material thing to private use with the result that the general public is deprived of enjoying the use of what is diverted. It is a manifestation of multiplicity of actions that are harmful to institutions.

Professor Adeyemi ,A, A (1998) , Economic and Financial crimes manifest in different forms like, corruption, tax evasion, large scale banking and insurance frauds, illegal mining, maritime fraud schemes, illegal currency manipulations, illegal capital transfers, currency counterfeiting, fraudulent bankruptcy, fraudulent overproduction, diversion of products, false invoicing including over invoicing, massive transfer of vital commodities, smuggling consumer crimes, corruption especially by public servants and theft by employees.

Ayozie, D O (2014) defines fraud as a noticeable unethical practice by a privileged bank worker who takes undue advantage of a vulnerable /weak customer. Unprofessional and unethical practices and behavior are summarized

as the abuse of the confidence, trust and interest the customers and public reposes in the directors , managers and staff of the commercial banks. Fraud can be described as a conscious premeditated action of a person or group of persons with the intention of altering the truth (facts and or figures) for selfish personal monetary gain. The action usually takes the form of forgery, falsification of documents and signatures.

The UN defines economic crimes or offences as that group of offences frequently committed in conjunction with legitimate economic activities and largely by perpetrators who enjoy a considerable amount of respect in their communities. The perpetrators of these acts seldom perceive themselves as criminals in the strict sense, a view shared by their peers and relatives.

CAUSES OF FRAUDS/CORRUPTION

The different reasons have adduced for the fraudulent practices among employees and management. Some of the causes are;

- Absence of a common definition of what fraud is or what it is not,
- Human depravity ,
- Greed , covetousness and avarice
- Internalization of the financial systems particularly for money laundering activities,
- Poor reward system
- Emergence of information technology,
- Socio – economic conditions/ Poverty
- Absence of stringent sanctions,
- Lack of corporate discipline and practice ,
- Lack or failure of internal control systems,
- Weak board oversight function
- A compromised management.

IMPLICATIONS OF RISKS AND FRAUDS ON ECONOMY

The consequential effects of risks (business or financial) and frauds are enormous both on the institutions and the economy as well. The negative or adverse results affects all stakeholders namely, Depositors, Investors, Shareholders, Employees, Management staff, Directors, Regulators, financial system and Economy.

1. Depositors – financial risks such credit risk, default risk or liquidity risk have in past resulted into the bank failure. Similarly frauds have caused the fall and closure of many big institutions. In such situations the primary victims are the depositors who lose their funds in the system.
2. Investors- This group of stakeholders is not spared of the consequences of the dangers of unmitigated risks and effects of frauds as they would lose all their investments in the event of failure or closure.
3. Shareholders – being the owners of the institutions, they stand to lose everything they have individually invested or in times of financial distress they may be called to make additional investments to bail out the institution if there is hope of surviving.

4. Employees – In the event of failure or closure there will job loss and reputational crisis or stigmatization of relationship with the failed or distressed institution. The societal challenge is better imagined on the relatives and dependents
5. Top Management – this group are would face both moral and professional challenge in their future life whether they are directly or indirectly in the actions that caused the institutions to fail. The possibility of asking criminal or civil charges might not farfetched.
6. Directors – as the agents of the shareholders and the highest organ are also affected morally and financially. The directors suffer material and financial losses apart the moral or integrity that has been battered.
7. Regulators- The regulatory bodies are not spared as they would have to time and resources as financial undertakers, to compensate the depositors and perhaps involve in recovering of residual assets
8. Institutions – as entity is allowed to bleed to premature through loss of assets and goodwill.
9. Financial System- There is contagious effects that might spill over to the whole financial systems if not well managed. If such failing institution is a major player that controls large market in terms of customers base or risk assets. The effects would definitely be grievous on the whole financial systems such that there other organisations might fall along.
10. Economy - The economy on doubts suffers through loss of funds, job loss, loss of public confidence, investors losing interest in the system, , social crisis might result in the whole nation.

PLACE OF RISK MANAGEMENT FRAMEWORK

Risk management is usually define as the process of managing the probability or negative effect of the adverse occurrence to an acceptable range or within the limit set by the management of the Institution. In other words risk management involves taking reasonable risk through a systematic approach that identifies and categorizes the risk effects and implementing strategies to reduce possible losses.

Nwankwo (2004) opines , as in other area of bank operations, an effective management of banking risks requires a well articulated risk management policy and strategy as such policy assist bank management to think through the totality of its operations and the risks inherent in the operations, see the risks in totality as affecting the bank as a corporate entity rather than as individual risks affecting separate departments and units of the bank, assign responsibilities , and establish the machinery for implementation, appraisal and review.

The processes involve in risk management are;

- **Risk identification**: it entails identifying and accessing risks that might impact on the institution directly or indirectly.
- **Risk analysis/measurement**: it involves properly analyzing or measuring the risks in order to determine the management tolerance level for each identified risk
- **Risk mitigation** : it is designing strategies, plans or policies to reduce the possible damage or loss of an identified risk to an acceptable level

- **Risk monitoring**: this involves articulating strategies or measures to track the identified risks and its possible impact.
- **Risk management** : it is formulating appropriate risks strategies and periodically reviewing measures put in place for risk reduction mechanism

STRATEGIES FOR MANAGING RISK

There are four (4) basic approaches to risk management which are;

- Risk Retention
- Risk Transfer
- Risk Mitigation/reduction
- Risk Avoidance

The responsibility of effective risk management lies with the Board of Directors and Top management of the Institution. While designing appropriate risk management framework, the two organs should inculcate these important features into the risk management programme, (i) it must be anticipatory (ii) it must be comprehensive (iii) it must be flexible and (iv) it must be well defined tasks and responsibility for all stakeholders.

INSTITUTIONAL CAPACITY FOR FRAUDS CONTROL

Reading through many of slogans of different institutions you are likely to come across such words as transparency, integrity, accountability, equity, honesty, and many, unfortunately the practices in these establishments are completely at variance with these principles.

Fraud is so pervasive and can be found in every aspect of the human this is due mainly to the depravity of the human nature. It would therefore be absolutely impossible to completely eradicate fraud from either an institution or society. As long the society exists fraud would continue, **as iniquity will abound**, (grow,) what can be done is adoption of specific measures to reduce is veracity in the financial institutions.

Internal Control System

Internal control is the institution‘s mechanism to monitor risks before and after operations. It is the procedure and process put in place for the safety of the assets of the organisation and efficient running of the system. Internal controls are all of the resources and procedures used by managers to properly control their activities. Internal control system is the way management deploys the organisation's resources to achieve corporate objectives. The objectives of Internal control are preventive, detective and corrective. Internal controls will help among others;

- Preserve the safety of assets

- Improve quality of customer service
- Ensure reliability of financial information
- Ensure staff adherence to policy and guidelines

Internal Audit

Internal Audit is a systematic ex-post appraisal of an institution's operations and financial reports to ascertain accuracy and integrity of financial reports, compliance with policies and procedures. It is an independent assessment to examine and evaluate business activities of an institution to determine compliance level of the institution to established standards. Internal audit must be done regularly, randomly and consistently.

INSTITUTIONAL CULTURE AND ORIENTATION- ESSENTIAL REMEDY

Furthermore, to effectively tackle these malaises there must;

- Spiritual and moral transformation among all the stakeholders in the institution. A change of attitude and orientation
- Value system must change – The materialistic tendency as a measure of social status must be altered. Individuals must start to appreciate and give high premium to integrity and honesty in all endeavour
- Larger society must withdraw recognition from all known perpetrators of frauds in the society. The society must physically withdraw membership and approvals from all who have stolen funds or wealth in whatever form.
- Institutional culture of probity and justice must be embraced and enforced in every organ in the business enterprise
- Sanctions and punishments must be meted out to all who are involved in any form of fraudulent activities or the other in the organisation
- Established processes and procedures must be strictly followed
- Legal and Judicial systems must be purged and repositioned to render unbiased judicial support against the fight of fraud practices.

RECOMMENDATIONS

Fraud control measures include fraud identification/detective measures, fraud prevention measures, fraud insurance fraud investigation and application of legal follow up on results of investigation through either civil

action or criminal action. As a way of reducing the losses arising from fraudulent practices among personnel of microfinance institutions, it is important to apply the following strategies;

1. Segregation of Duties
2. Know your customer KYC – carry out due diligence on customers
3. Comply with Anti money laundering rules and regulations
4. Establish Whistle blower policy and practice.
5. Strictly enforce internal control system.
6. Good staff selection process should be put in place
7. Ensure good referrals and introduce guarantor ship for your staffing plan
8. Always conduct background checks of your personnel and credit history of clients
9. Introduce field supervision and monitoring
10. Constantly review your internal control mechanism
11. Encourage Vacation/Annual leave and job rotation
12. Introduce spot checks for marketing and operations staff
13. Acquire good technology to drive your business with instant transaction alert for every business transaction of your client
14. Encourage your clients to visit your business office
15. Implement policies
16. Allow staff to proceed on annual leave whenever due
17. Cultivate the habit of regularly training your staff member

CONCLUSION

Financial institutions cannot avoid risks in their business activities as financial intermediaries they must established an efficient mechanism to identify, measure and manage risks properly. Fraud is the one enemy of the business community and cause the fall and collapse of many organisations both financial and non financial institutions. As long humanity exists fraud would be continue , to tackle this problem of fraud there is need for Institutional culture of integrity and moral uprightness that must embraced by stakeholders otherwise the consequences of unmitigated risks and unabated fraudulent practices would be too grave on all parties and the economy.

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