**AN EXAMINATION OF INTERNAL CONTROL SYSTEM AND BANK FRAUD PREVENTION IN NIGERIA BANKING INDUSTRY**

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**Abstract**

This study mainly focuses on internal control system and bank fraud prevention in Nigeria banking industry. Internal control plays a significant role in the Nigeria banking industry. Internal control are policies, procedures, practices on organizational structure implemented to provide reasonable assurance that organization’s business objective will achieve and undesired risk event will be prevented or detected and corrected based on either compliance or management initiated concerns. The researcher uses survey design hence, the use of questionnaires, personal interview and observation in data collection. Hypotheses were formulated and analyzed with the use of chi-square test at 5% level of significance. The findings revealed that bank with internal control system can prevent the menace of fraud and a good internal control system has a significant affection on fraud detection and control. The study concludes that Lack of good internal control measure is a major cause of fraud in various banks and recommends among others that banks in Nigeria should pursue and effective internal control measures to prevent fraud.

**CHAPTER ONE**

**INTRODUCTION**

* 1. **Background of the study**

The significance of internal control in Nigerian banks cannot be overstated. It is now considered a crucial aspect of organisational strength. This is primarily because a well-functioning control system is essential for maintaining an efficient accounting system. The importance of internal control systems in organisations, particularly banks, cannot be underestimated. This is because the banking sector plays a critical role in the economic development of a nation, but is currently facing challenges such as macroeconomic instability, sluggish growth in real economic activities, corruption, and the risk of fraud. Fraud has emerged as a significant challenge for many Nigerians, leading to the establishment of internal control systems as a primary solution. Furthermore, it is regrettable that Nigeria's international reputation has been consistently affected by this issue. The prevalence of fraud within the Nigerian banking system is a significant concern, particularly for banks with inadequate internal control systems. The impact of fraud on banks has been extensive and requires immediate attention. The research study focuses on the internal control system and bank fraud prevention in the Nigerian banking industry, specifically using Union Bank Plc as a case study. This topic arises from the need to address the economic degradation and find solutions to mitigate fraud in the banking sector. This study seeks to validate the notion that an internal control system that is both effective and efficient is the most effective means of preventing and detecting fraud, particularly within the banking industry.

**1.2 STATEMENT OF THE PROBLEM**

Considering the effects by fraud and fraudulent act as pointed in the introduction, the problem of this study is to effectively comb and curb the incidence of fraud. Yet they have not been able to stop bank fraud completely. For this reason, this research was carried out to help the banks in looking for ways of preventing bank fraud to achieve the objective, and this research work will be guided with questions.

**1.3 OBJECTIVE OF THE STUDY**

The objective of this research is basically aimed at the following:

1. To determine if lack of good internal control a major cause of fraud in bank.
2. To ascertain whether banks with internal control system prevent menace of frauds in Nigeria.
3. To determine if bank personnel commit fraud.
4. To ascertain how effectively fraud control measure is in Nigerian banks.

**1.4 RESEARCH HYPOTHESES**

**Hypothesis One**

**HO:**The lack of a good internal control is not a major cause of fraud in banks.

**HI:**The lack of a good internal control is a major cause of frauds in Nigeria.

**Hypothesis Two**

**HO:**Banks with internal control system cannot prevent the menace of fraud in Nigeria.

**HI:**    Banks with internal control system can prevent the menace of fraud in Nigeria.

**1.5 SIGNIFICANCE OF THE STUDY**

From all experience, fraud is unique in terms of the system of planning and execution.

Knowledge of the various ways which fraud have been perpetuated in the past and foresight or anticipation system considering the past can facilitate an adequate internal control design that can be efficient and effective in guiding management in the prevention and re-occurrence of fraud. If it is agreed that majority of fraud are born by the bank, then banks should pursue effective internal control measures to prevent fraud. The research work therefore is designed to help to get acquainted with various frauds and their method of execution with the view of gaining sufficient knowledge to enrich individuals and collective experience in management and prevention of fraud.

**1.6 SCOPE AND LIMITATION OF THE STUDY**

This study examines the nature and prevention of bank fraud in Nigeria banking system and is based on knowing how good internal control relates with the prevention of bank frauds in the Nigeria banking. The study is based strictly in Nigeria banking system and more emphasis is based in Auchi, the research work uses a time frame of 5 years (2009 – 2013) using a sample size of 75 for effective result. The researcher encounters some constrain which limited the scope of the study;

**a) AVAILABILITY OF RESEARCH MATERIAL:** The research material available to the researcher is insufficient, thereby limiting the study

**b) TIME:** The time frame allocated to the study does not enhance wider coverage as the researcher has to combine other academic activities and examinations with the study.

**c) Organizational privacy**: Limited Access to the selected auditing firm makes it difficult to get all the necessary and required information concerning the activities

**1.7 DEFINITION OF TERMS**

The following are the definition of certain terms used in writing the project which the research feels that there may not be so conversant with.

1. **Fraud:** This is an act or cause of deception deliberately practiced to gain unlawful and unfair advantage such deception is directly to the detriment of another person or group of persons.
2. **Fraudulent:**Means deceitful, a person who commit frauds.
3. **Internal Audit:**Means an independent appraisal unit within an organization for the review of operation and service to management in a managerial control by measuring and evaluating the effectiveness of others.

**1.8 ORGANIZATION OF THE STUDY**

This research work is organized in five chapters, for easy understanding, as follows

Chapter one is concern with the introduction, which consist of the (overview, of the study), historical background, statement of problem, objectives of the study, research hypotheses, significance of the study, scope and limitation of the study, definition of terms and historical background of the study. Chapter two highlights the theoretical framework on which the study is based, thus the review of related literature. Chapter three deals on the research design and methodology adopted in the study. Chapter four concentrate on the data collection and analysis and presentation of finding. Chapter five gives summary, conclusion, and recommendations made of the study

**CHAPTER TWO**

**REVIEW OF RELATED LITERATURE**

**2.1 INTRODUCTION**

Adetiloye, Olokoyo and Taiwo (2016) examined the issues of internal control viz., fraud prevention in the banking industry, adopting both primary and secondary data. Primary data was used to test internal control while secondary data were employed to test fraud prevention. The main primary variables were separation of duties, monitoring, and staff qualifications while the main secondary variables are bank profit, regulation, technology and Money supply. In both cases regression techniques were adopted. The results show that internal control on its own is effective against fraud, but not all staff are committed to it, while the secondary data is quite supportive of the primary data but more exemplifying in that money supply, staff qualifications and technology were significant throughout the various dependent variables. It is also clear from the regressions that technological based fraud is significant. Ozigbo (2015) carried out a study to examine internal control and fraud prevention in Nigerian business organizations. A survey was undertaken in some selected firms in Warri metropolis. It was discovered that internal control has a significant relationship with fraud prevention. They therefore concluded that internal control was a necessary safeguard which assures absentee owners of business that their fund is being utilized efficiently. It was recommended among others that proper accounting record should be kept at all times and authorization and approval limits of jobs and funds should be setup and communicated to all concerned interest groups. Oguda, Odhiambo and Byaruhanga (2015) in a paper ascertained the effect of internal controls on fraud prevention and detection in district treasuries of Kakamega County. Purposive sampling method was used to select Treasury Staffs while simple random sampling method was used to select Heads of Departments to respond to the data collection instruments. The study used closed ended questionnaires designed for treasury staff and their clients and was administered by the researcher though drop and pick method. Key respondents were Senior Treasury Staffs and Heads of Departments in Kakamega County. Oguda, Odhiambo and Byaruhanga (2015) in a paper ascertained the effect of internal controls on fraud prevention and detection in district treasuries of Kakamega County. Purposive sampling method was used to select Treasury Staffs while simple random sampling method was used to select Heads of Departments to respond to the data collection instruments. The study used closed ended questionnaires designed for treasury staff and their clients and was administered by the researcher though drop and pick method. Key respondents were Senior Treasury Staffs and Heads of Departments in Kakamega County. Data collected was analysed using both descriptive and inferential statistics using Statistical Package for the Social Science (SPSS). Reliability and Validity of data collection instruments was ascertained through the testretest method. Findings of the study revealed that there was a statistically significant and positive relationship between the adequacy of internal control systems and fraud prevention and detection in district treasuries in Kakamega County. Data collected was analysed using both descriptive and inferential statistics using Statistical Package for the Social Science (SPSS). Reliability and Validity of data collection instruments was ascertained through the test-retest method. Findings of the study revealed that there was a statistically significant and positive relationship between the adequacy of internal control systems and fraud prevention and detection in district treasuries in Kakamega County. Wei-Huang (2015) in a study examined the relationship between audit committee characteristics (the number of audit committee meetings, the number of audit committee members and the number of audit committee financial experts) and fraud, a proxy for potential fraudulent financial reporting. Using a final sample of 218 firms from S&P SmallCap600 with a December 31, 2003 fiscal year-end and audit committee characteristics data collected from the SEC database. We find that the (1) Meeting frequency of the internal control is not associated with fraud prevention; (2) Number of internal control members does not significantly affect fraud prevention and (3) Financial expert is significantly associated with fraud prevention Ayagre, Appiah-Gyamerah and Nartey (2014) in a study evaluated the control environment and monitoring activities components of Internal Control Systems of Ghanaian Banks using COSO‟s principles and attributes of assessing the effectiveness of internal control systems in helping to prevent fraud. A five point Likert scale was used to measure respondent‟s knowledge and perception of internal controls and the bank‟s internal control system effectiveness. Responses ranged from strongly disagree to strongly agree, where 1 represented strongly disagree (SD) and 5 represented strongly agree (SA). Statistical Package for Social Sciences (SPSS) was used to analyze data and presented in the form of means and standard deviations for each question and each section of the questionnaire. The study found out that, strong controls exist in the control environment and monitoring activities components of the internal control systems of banks in Ghana and this invariably assists in the deterrence of fraud. Mukoro, Faboyede and Eziamaka (2014) in a study examined the effectiveness of forensic accountants in strengthening internal control of business organizations in Nigeria. The study aimed at investigating how fraud can be managed and handled in business organizations. The study employed survey research and the sampling technique employed was the purposive sampling with a sample of five companies that was selected. A total of 100 copies of questionnaire were distributed to the staff of the selected business organizations. The data collected were analyzed using Statistical Packages for Social Sciences (SPSS). All the hypotheses were tested using Regression Analysis. The results of the empirical findings showed that internal control and its components play a significant role in controlling fraud in business organizations. Mukoro, Faboyede and Eziamaka (2014) in a study examined the effectiveness of forensic accountants in strengthening internal control of business organizations in Nigeria. Companies were chosen due to the important role they play in increasing the level of economic activity. The study aimed at investigating how fraud can be managed and handled in business organizations. The study employed survey research and the sampling technique employed was the purposive sampling with a sample of five companies that was selected. A total of 100 copies of questionnaire were distributed to the staff of the selected business organizations. 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The research was conducted using both quantitative and qualitative approaches; adapting cross-sectional survey research design. The study used both primary and secondary data. Primary data was collected using structured questionnaire and interview, while secondary data was obtained from financial statements of the sampled enterprises. Data was analyzed using descriptive statistics as well as inferential statistics. The study specifically revealed that a significant change in financial performance is linked to internal controls systems. Based on the findings of the study, it is concluded that internal control systems as supported by the study findings significantly influence the financial performance of Small and Medium scale Enterprises. The investigation recommends training on the significance of internal controls among proprietors of Small and Medium scale Enterprises. Kamau (2013) sought to determine the effect of internal control system on financial performance of manufacturing firms in Kenya. To achieve the objective of this study, the study used hypothesis testing research design. The study tested the following hypotheses: H1: Internal Controls and Financial Performance are positively related; H2: Internal Controls have a significant impact on Financial Performance. The population chosen for this study was 65 manufacturing firms registered by ministry of industrialization in Kenya. The study selected a sample of 20 manufacturing firms from a target population of 65 manufacturing firm. The sample was drawn using stratified random sampling technique. The study relied on both primary and secondary data. Primary data was collected using structured questionnaires while the secondary data was gathered from financial statements based on availability and accessibility of data. The findings revealed that most manufacturing firms had a control environment as one of the functionality of internal controls of the organization that greatly impacts on the financial performance of the firms. It was also established that the management had put in place mechanisms for mitigation of critical risks that may result from fraud. Josiah, Adediran and Akpeti (2012) focused on the role of auditors in the use of internal control system in fraud detection: a survey of selected firms in Nigeria. The data collection technique used for this study is questionnaire and oral interview was also supportive. The data was analyzed through the use of chi-square, the findings of this work are that the firm’s produced and published financial statement as well as engaging the services of auditors and that detection of fraud and errors is inevitable. And also, the case of fraud in these organizations is due to poor management, lack of internal auditors, poor internal control system and corruption. Chukwu (2012) carried out a study to examine the relationship between internal measures to proper accounting records. A survey research design was adopted for this research study and a sample size was selected using Yaro Yamane sampling technique as data used were obtained from both primary and secondary sources. Four research questions were formulated out of which three hypothesis were formulated using regression co-efficient analysis method at 5% level of significance and the Z table was also used for comparison between calculated value of significance B and table value. The finding from the analysis indicates that internal control measure management performance. The study also found that fraud perpetration and losses of revenue in an organisation are not a result of internal control system. Badara (2012) in a paper assessed the role of internal auditors in ensuring effective internal control and preventing financial crime/ detecting fraud at local government level, a case of Alkaleri L.G.A Bauchi State. The methodology employed for data collection is only primary source, which involved the use of questionnaires, in which 50 questionnaire were administered to the staff of Accounting and Internal audit department of Alkaleri L.G.A, out of which only 35 questionnaires were completed and returned. The data generated for the study were interpreted using simple percentage. The main finding of the study include among other; lack of proper independent exercise by the internal auditor, understaffing in the side of internal audit unit, the internal control system is very weak toward financial and other controls. The paper recommends that the internal control system should be efficient in such a way that it will prevent any act of financial crime and detection of fraud. Josiah, Adediran and Akpeti (2012) focused on the role of auditors in the use of internal control system in fraud detection: a survey of selected firms in Nigeria. The data collection technique used for this study is questionnaire and oral interview was also supportive. The data was analyzed through the use of chi-square, this findings of this work are that the firm’s produced and published financial statement as well as engaging the services of auditors and that detection of fraud and errors is inevitable. And also, the case of fraud in these organizations is due to poor management, lack of internal auditors, poor internal control system and corruption. Based on these findings, it is recommended that selected firms should ensure continuous policies and strategies aimed at effective and efficient internal control system. That management should continually engage the services of qualified and experienced external auditors which will not only put in place an effective internal control system but which will equally enhance it. Chukwu (2012) carried out a study to examine the relationship between internal measures to proper accounting records. A survey research design was adopted for this research study and a sample size was selected using Yaro Yamane sampling technique as data used were obtained from both primary and secondary sources. Four research questions were formulated out of which three hypothesis were formulated using regression co-efficient analysis method at 5% level of significance and the Z table was also used for comparison between calculated value of significance B and table value. The finding from the analysis indicates that internal control measure management performance. The study also found that fraud perpetration and losses of revenue in an organisation are not a result of internal control system. Dineshkumar and Kogulacumar (2012) tries to study to what extent internal control systems influence on the performance of the Sri Lankan Telecom limited. Primary data and secondary data were used for this study, but study solely depends on primary data collection technique. The primary data collection techniques were used in this research they were Questionnaire, Interview & Observation. The samples were selected from staff of the Sri Lanka Telecom limited. Thus sixty (60) employees of the company were selected. Percentage, Correlation and SWOT analysis were the main tools used in the analysis. The findings of the study showed there is a strong relationship between internal control system and organizational performance of the Sri Lanka Tele com limited. And also internal control of the Sri Lanka Tele com limited will lead to high organizational performance in the future. Olumbe (2012) conducted a study to establish the relationship between internal controls and corporate performance in commercial banks in Kenya. The researcher conducted a survey of all the 45 commercial banks in Kenya. It was concluded that most of the banks had incorporated the various parameters which are used for gauging internal controls and corporate governance. This was indicated by the means which were obtained enquiring on the same and this showed that the respondents agreed that their banks had instituted good corporate governance with a strong system of internal controls and that there is a relationship between internal control and corporate performance. Barra (2010) investigated the effect of penalties and other internal controls on employees‟ propensity to be fraudulent. Data was collected from both managerial and nonmanagerial employees. The results showed that the presence of the control activities, separation of duties, increases the cost of committing fraud. Thus, the benefit from committing fraud has to outweigh the cost in an environment of segregated duties for an employee to commit fraud. Further, it was established that segregation of duties is a “least-cost” fraud deterrent for non-managerial employees, but for managerial employees, maximum penalties are the “least-cost” fraud disincentives. The results suggest the effectiveness of preventive controls control activities such as segregation of duties is dependent on detective controls. Kakucha (2009) evaluated the level of effectiveness of internal controls of enterprises operating in Nairobi. The study was quantitative and was conducted between September 2007 and June 2009 using a sample of 30 small businesses as listed in the National Social Security Fund (NSSF) Register of Kenya. Primary data was collected from the managers of the small business using interviews and examination of documents pertaining to internal controls. The study established that there are deficiencies in the systems of internal controls, with the degree of deficiencies varying from one enterprise to another. The components of internal control that were missing in most businesses surveyed were: firstly, risk analysis, and secondly lack of proper flow of information. In addition, the study established that the sample population had limited awareness of what constituted an effective system of internal control. The study also found that there is a negative relationship between the age of an enterprise and the effectiveness of its system of internal control while a negative correlation between the resources held by an enterprise and its internal control system weaknesses exists. Amudo and Inanga (2009) also carried out a study in Uganda to evaluate the internal control systems that the regional member countries of the African Development Bank Group institute for the management of the Public Sector Projects that the Bank finances. There are 14 projects of the bank‟s public sector portfolio in Uganda. The 27 data received and analyzed is for eleven projects. Three projects were omitted because they were not fully operational to install effective internal control systems. The study identified the following six essential components of an effective internal control system: control environment, risk assessment, control activities, information and communications, monitoring and information technology. The outcome of the evaluation process was that some control components of effective internal control systems were lacking in those projects. These rendered the control structures ineffective. Jones (2008) compared internal control, accountability and corporate governance in medieval and modern Britain. He used a modern referential framework (control 28 environment, risk assessment, information and communication, monitoring and control activities) as a lens to investigate medieval internal controls used in the twelfth century royal exchequer and other medieval institutions. He demonstrated that most of the internal controls found today were present in medieval England. Stewardship and personal accountability were found to be the core elements of medieval internal control. The recent recognition of the need for the enhanced personal accountability of individuals is reminiscent of medieval thinking.

**2.2 FINANCIAL FRAUD**

Fraud is a universal phenomenon that has been in existence for so long. Its magnitude cannot be known for sure, because much of it is undetected and not all that is detected is published. Fraud however has been defined by many scholars; Olufidipe (1994) defined fraud as „deceit or trick deliberately practiced in order to gain some advantages dishonestly‟. According to Boniface (1991), fraud is described as „any premeditated act of criminal deceit, trickery or falsification by a person or group of persons with the intention of altering facts in order to obtain undue personal monetary advantage‟. Another scholar Idowu (2009) also sees fraud as a deliberate falsification, camouflage, or exclusion of the truth for the purpose of dishonesty/stage management to the financial damage of an individual or an organization. Fraud literally means a conscious and deliberate action by a person or group of persons with the intention of altering the truth or fact for selfish personal gain (Ajayi, 2010). According to Webster (1972) the word fraud means deceit, a trick, dishonest practice or a breach of confidence. The Oxford Advanced Learner’s English Dictionary defines fraud as a criminal deception. That is to say, a fraud is any act of deception which is deliberately practiced in order to gain something dishonestly. Therefore, for any action to constitute a fraud, there must be a proof of dishonest intention to benefit one major person at the expense of the other. According to Robertson (1996) fraud “consists of knowing or making material misrepresentation to a fact with an intention to inducing someone to believe to suffer a loss or damage. Fraud, involves the use of deception to obtain an unjust or illegal financial advantage (Okezie 1995). Agbadua (1980 as cited in Ogidefa, 2008) also opined that fraud is an anti economic process and must properly be dealt with. Ade (1982) sees fraud as a virus which spreads from the banking sector to other economic activities and organization even the government. EFCC Act (2004) defines fraud as illegal act that violates existing legislation and these include any form of frauds, narcotic drug, trafficking, money laundering, embezzlement, bribery, looting and any form of corrupt malpractices and child labour, illegal oil bunkering and illegal mining, tax evasion, foreign exchange malpractice including counterfeiting, currency, theft of intellectual property and piracy, open market abuse, dumping of toxic waste and prohibited good (Aduwo, 2016). This definition is all-embracing and conceivably includes financial crimes in corporate organization and those discussed by various authors (Khan, 2005; William, 2005). The Institute of Professional Practises Framework (Sommer, 2014) defines fraud as any illegal act characterized by deceit or concealment or violation of trust which do not directly depend on the use of violence, perpetrated in firms to obtain money, property, or services; to avoid payment or loss of services; or to secure personal or business advantage. Williams (2005) describe fraud to include bribes, cronyism, nepotism, political donation, kickbacks, artificial pricing and frauds of all kinds. According to Agwu (2013), fraud is any illegal act characterized by deceit, concealment, or violation of trust. These acts are not dependent upon the threat of violence or physical force. Frauds are perpetrated by parties and organizations to obtain money, property, or services; to avoid payment or loss of services; or to secure personal or business advantage. It has also been viewed as an illegal act involving the obtaining of something of value through willful misrepresentation. According to another definition, fraud is to create a misjudgment or maintain an existing misjudgment to induce somebody to make a contract (Arzova 2003). Akinyomi (2010) view fraud as the act of depriving a person underhandedly of something, which such a person would or might be entitled to but for the perpetration of fraud in its lexical meaning, fraud is an act of trickery which is intentionally practiced in order to gain illegitimate advantage. Therefore, for any action to constitute a fraud there must be deceitful objective to benefit (on the part of the perpetrator) at the disadvantage of another person or group. Fraud typically requires stealing and manipulation of accounts, frequently accompanied by cover up of the theft. Chakrabarty (2013) defines fraud as any behavior by which one person intends to obtain a dishonest advantage over another where the person makes an illicit gain while the other party incurs a loss. Curtis (2008) argues that fraud encompasses the acquisition of property or economic advantages bymeans of deception, through either a misrepresentation or concealment. Fraud is the act of intentionally deceiving someone in order to gain an unfair or illegal advantage (financial, political or other). The primary responsibility for the prevention of fraud rests with both those charged with governance of the entity and management. It is important that management, with the oversight of those charged with governance, place a strong emphasis on fraud prevention, which may reduce opportunities for fraud to take place, and fraud deterrence. Fraud can also be defined as the use of deception to obtain an unjust or illegal financial advantage. The internal control auditing guidelines (number 11, Aeufa, Kola and Oluwookere, 2001) describe fraud as; misappropriation of fund; Misapplication of assess; Recording of transaction with substance (source documents); Misapplication of accounting management policies; and Suppression and omission of the effect of transaction from records and documents. Other forms of fraud include, bribery, carryover fraud, electronic media fraud, alteration of invoice, double payment involve, false declaration, teaming and lodging, actual theft cash balance, forgery. Because fraud negatively impacts organizations in many ways financial, reputational, and through psychological and social implications it is important for organizations to have a strong fraud prevention program. It should include awareness, prevention, and detection programs, as well as a process to identify risks within the organization. To prevent fraud, it is necessary to build controls in all the five areas of resources namely; man power, machinery and time factor (Akpoyomare, 1996).

**2.3 INTERNAL CONTROL QUALITY**

The most effective way of reducing frauds is to establish an effective internal control system. Effectiveness is a word that has been defined by different researchers, for instance Arena and Azzone (2009) defined internal control quality as the capacity to obtain results that are consistent with targets objective, while, Dittenhofer (2001) view internal control quality as the ability toward the achievement of the objectives and goals. Internal control systems operate at different levels of effectiveness. Internal control can be judged effective in each of the three categories, respectively, if the board of directors and management have reasonable assurance that: They understand the extent to which the entity's operations objectives are being achieved, published financial statements are being prepared reliably, applicable laws and regulations are being complied with. Also effective internal control requires; appropriate accounting procedure and system, division of duties i.e. separation of responsibilities, especially those of authorization, regular verification of supervision of each person’s work by their superior officers (Badara, 2012). The effectiveness of an internal control system is dependent on how fluid the system interact with itself and how embedded it is into the organizations business processes. Again for an internal control system to be effective and provide that needed assurance to the board, there should be some agents of effectiveness (Ayagre et al, 2014).

**2.4 MEASURES OF INTERNAL CONTROL QUALITY**

Certain factors can affect the quality of the internal control and how effective the internal control can be in its quest of reducing financial fraud. These factors include; size of the internal control unit and the independence of the internal control unit.

**(i). Internal Control Size**

The magnitude of the internal control is the sum of memberships of the group chosen by the governing bodies. This figure of memberships is taken as a sign of means accessible to the group. Where a large audit committee member exist, it is likely that possible challenges emanating from financial reporting task has the likelihood of being exposed and settled (Mohammed-Nor et al 2010).Lipton and Lorsch (2011) remarked that the ability of the internal control unit oversight function rises when the figure of its memberships increases. Yermack (1996) posits that, a lesser audit committee magnitude improves on firms‟ worth. This stand corresponds with Jensen (1993) assertion that a small sized internal control unit enhances the efficiency with which the internal control unit engages in oversight and control. However, Mansi and Reeb (2004) noted that an internal control unit size that is large spends a considerable period and means to check the financial reporting process and internal control mechanism. These inputs suggest that size constitutes a significant factor for the effective performance

**(ii). Internal Control Independence**

As per the SOX (2002), an audit committee is to be constituted entirely of independent directors. Such increased requirements of having an independent internal control unit not only act as an internal control mechanism to mitigate unwanted interventions and conflicting pressures of powerful groups in the firm, but also to improve oversight and monitoring of executives. Therefore, it is expected that with the relatively high proportion of independent directors in the boards and internal control unit as internal control tool, would enhance the objectivity, reliability and transparency of the financial reporting and disclosures; which in turn would strengthen investors’ confidence, (Duchin et al., 2010). The internal control unit plays an important role in monitoring and overseeing the financial matters of a company. Thus, any effort made or steps taken by management to engage in manipulation of earnings or misappropriation of assets should be detected and stopped by the audit committee. At least three members of the internal control unit in a company should be independent and non-executive directors (Kamarudin & Ismail, 2014). An independent internal control unit has a negative association with fraudulent financial reporting.

**2.4 FRAUD IN THE NIGERIA BANKING INDUSTRY**

Fraud in the Nigerian banking industry has always been at an alarming rate. Despite the major important role the sector plays in the economic development, its failures are becoming well noticeable. According to The Dictionary of Economics and Commerce, 200 banks were reported to be distressed in England between 1815 and 1850; fraud has been recognized as one of the reasons attributed to this failure. The problem of fraud in the banking industry is a general issue that is not attributed to any economy, nation, or environment. The origin of bank distress in Nigeria can be traced back to the 1930s bank distress and crises. Nwankwo (1994) wrote that “the crises of confidence in Nigerian banking sector is not a new one, it has been with us for a long time. It occurred again during the banking doom and crash of the 1940s when all but four indigenous banks failed. In the late 1990s, 26 failed banks were liquidated at once while others went through various operations ranging from restructuring, renaming, acquiring and complete sales to new investors. One thing that in constant in all the banking reforms was that, fraud was a prominent factor in major failures. Several laws were put in place to reduce, alleviate and if possible eliminate the occurrence and incidences of fraud in the sector most popular among them are:

**The Criminal Code Act, 1990 laws of the Federation**: The criminal code of the federation exits above all other laws related to fraud issue in Nigeria. Though the law did not define fraud in an actual sense it makes provisions against frauds committed against banks. Section 435 of the criminal code act makes it a punishable offence with maximum imprisonment of seven years for any director or officer of the bank who destroys, alters, mutilates, or falsifies any book, document, valuable security, or account which belongs to the bank. Section 436 also imposed punishment of a maximum of seven years on any staff or auditor of the bank who commits offences related to section 435. Finally, section 472 also makes punishable provision for any person with the intent to defraud of a bank either through crossings on a cheque, or to alter cheques which crossings has been obliterated (CCA 1990).

**The Banks and Other Financial Institutions Decree no. 25, 1991 (BOFID)** : The Central Bank of Nigeria is empowered under the general provision of BOFID decree to license and regulate the activities of banks and other financial institution operating in Nigeria. The decree made provisions for punishable offences against any act committed by the directors or any other bank officers which are as threat to the normal running of a bank. Some of the provisions of BOFID that creates sanctions against malpractices in banks are explained below:

**Insider Abuse Act – Section 18**: This section prohibits insider abuse and imposes sanctions against any act of fraudulence associated with the granting of loans and or credit facility by banks. Going by this provision, managers or officers of the banks are required not to have any interest or derive benefit in any credit facility granted to the customers, but in a situation where any interest exists, such interest must be disclosed from the onset. More so, bank officers are not allowed by the provision of this act to grant any loan or credit facility contrary to their internal rules and regulations and where such provision speculated them to obtain collateral, such collateral must first obtained before granting of loan. Any deviation from this provision carries maximum imprisonment of 3 years or a fine of 100,000 naira apprx.250 Euro (BOFID 1991).

**Restriction on certain operations of the bank – Section 20:** This section restricts certain operations of the banks without prior approval from the Central Bank of Nigeria. Such operations include the maximum amount of loan or credit facility that can be granted to any customer. For merchant banks, it is 50% of the shareholders’ funds while 20% for commercial banks (BOFID 1991).

**Maintaining proper books of accounts – section 24**: This section made it compulsory for all banks to keep and maintain proper books of account in a safe place in respects of all transactions relating to the operation of the bank. Section 24(5) made it compulsory for bank directors and management to comply with the provision of this section in order to ensure that all financial statements submitted in relation to the bank are accurate and free from any form of falsification. Any director or bank officer who fails to comply with the provision of this act is liable to imprisonment of maximum five years or a fine of 10,000 Naira, approx. 30 Euro (BOFID 1991).

**2.5 MANAGEMENT FRAUD**

This type of fraud essentially refers to frauds committed by bank employees in top echelon that is, top management level staffs that are aimed largely at deceiving the shareholders and to a considerable extent, auditors and the regulatory authorities through deliberate presentation of false financial statement – the key device of perpetration (Jat, 1992). Like in other type of business endeavours, bank management frauds often take these two forms:

• Concealing inadequate business operation performances

• Concealing prohibited business activities.

Banks had until the outset of the prudential guidelines, presented over bloated fantastic profit positions in their dubious acts and return there on. These give shareholders and the government regulatory agencies the false impressions of their impressive performances and general health of bank, until the enforcement of the guidelines revealed the emptiness and terminally ill nature of most banks (Nwankwo, 1990). NDIC reports and other sources have revealed that top management bank officials have at time been behind several bank frauds. In a related report, Enechi (1998) states that “since NDIC commenced operations in 1995, it has prosecuted top class bank directors on offences contained in the failed banks. Investigations show that the majority of the Nigerian banks were perpetuated by those occupying privileged positions and those employed to protect the banks finances. For instance, the former Managing Director of Equity Bank, Mr. Zoaka Machar, was alleged to have used his position to steal N372.68million. In the same vein, the former branch manager of Nigeria Universal Bank, Alhaji Jinadu Munai took undue advantage of his position to defraud the bank of N12million (Omachonu and Ndulor, 1998)

**2.6 EMPLOYEE FRAUD**

Employee fraud refers to fraud committed by employees below management position. As distinguished from management fraud, employee fraud does not involve alternations or misrepresentation of financial statements or information but the outright misappropriation of assets of the bank or the alternation of individual instruments such as cheques, drafts, for their personal advantages. Typical examples of employee frauds are the conversions of cash or other assets of the employer to the fraudster’s immediate benefit. Like their management counterpart, quite a number of employee’s fraudulent acts occur after having gained a position of trust and responsibility. A considerable higher proportion of bank frauds are usually committed by employees in non-management positions majority of who are cashiers, clerks, accountants etc

**Perpetrator’s Method of Frauds**

According to Onkagba (1993) and Idowu (2009), though the list of methods is usually not exhaustive however, there are some common methods through which fraud can be perpetuated in the banks and other organizations:

**Foreign exchange fraud**: According to Ekechi (1990), this is the way by which the staffs of a company forge letters of credit and other foreign transaction documents paving way for illegal transfer of funds. **Cheque kitting**: This is explained as method by which depositor utilize the time required for cheque to clear to obtain an unauthorized loan without an interest charge.

**Till borrowing**: Staffers borrow from the till in form of I Owe You (I.O.U) with the hope of refunding it, but which eventually not done. Therefore, fictitious entries arises in that respect.

**Advance fee fraud**: This is the one which involves an agent approaching a bank or individual with an offer to access large funds at below market interest rate often for long term; the purported source of such funds is not specifically identified the only way to have access to it is through the agent who must receives a fee or commission “in advance” as soon as the agent collects the fee, he disappears into thin air and the facility never come through.

**Computer fraud**: Computer frauds can remain undetected for a long time. It can take the form of corruption of the programmed or application package and even hacking/breaking into the system via a remote sensor. Account opening fraud: This is categorized as the normal fraudulent practice by staff and customer to open current and banking accounts using fake documents into or from which fictitious transactions are transferred.

**Money transfer fraud**: Money transfer services are means by which the involved funds are transferred to or from a bank to a beneficiary account at any banking point worldwide in accordance with the instruction from the bank customers.

**Counterfeit securities**: This is known as the modern photographic printing equipment which has greatly aided criminals in reproducing good quality forged instruments. The document may be totally counterfeit stock or bonds as collateral for loan, other counterfeit items such as treasury notes and bankers acceptances may be presented to bank for redemption.

**2.7 THEORETICAL FRAMEWORK**

Theoretical framework is the structure that supports or backs the work of the study. The agency theory and institutional theory is discussed below as they relates to internal control.

**Agency Theory**

Agency theory is concerned with resolving problems that can exist in agency relationships; that is, between principals such as shareholders and agents of the principals for example, company executives. The two problems that agency theory addresses are: the problems that arise when the desires or goals of the principal and agent are in conflict, and the principal is unable to verify what the agent is actually doing and the problems that arise when the principal and agent have different attitudes towards risk. Because of different risk tolerances, the principal and agent may each be inclined to take different actions. Adams (1994) in his article stated that agency theory can provide for richer and more meaningful research in the internal audit discipline. Agency theory contends that internal auditing, in common with other intervention mechanisms like financial reporting and external audit, helps to maintain cost-efficient contracting between owners and managers. Agency theory may not only help to explain the existence of internal controls and internal audit in firms but can also help explain some of the characteristics of the internal audit department, for example, its size, and the scope of its activities, such as financial versus operational auditing. Agency theory can be employed to test empirically whether cross-sectional variations between internal auditing practices reflect the different contracting relationships emanating from differences in organizational form

**CHAPTER THREE**

**RESEARCH METHODOLOGY**

* 1. **Research design**

The researcher used descriptive research survey design in building up this project work the choice of this research design was considered appropriate because of its advantages of identifying attributes of a large population from a group of individuals. The design was suitable for the study as the study sought internal control system and bank fraud prevention in Nigeria industry

* 1. **Sources of data collection**

Data were collected from two main sources namely:

(i)Primary source and

(ii)Secondary source

**Primary source:**

These are materials of statistical investigation which were collected by the research for a particular purpose. They can be obtained through a survey, observation questionnaire or as experiment; the researcher has adopted the questionnaire method for this study.

**Secondary source:**

These are data from textbook Journal handset etc. they arise as byproducts of the same other purposes. Example administration, various other unpublished works and write ups were also used.

* 1. **Population of the study**

Population of a study is a group of persons or aggregate items, things the researcher is interested in getting information internal control system and bank fraud prevention in Nigeria industry. 200 staff of CBN Abuja was selected randomly by the researcher as the population of the study.

* 1. **Sample and sampling procedure**

Sample is the set people or items which constitute part of a given population sampling. Due to large size of the target population, the researcher used the Taro Yamani formula to arrive at the sample population of the study.

n= N

1+N (e) 2

n= 200

1+200(0.05)2

= 200

1+200(0.0025)

= 200 200

1+0.5 = 1.5 = 133.

**3.5 Instrument for data collection**

The major research instrument used is the questionnaires. This was appropriately moderated. The secretaries were administered with the questionnaires to complete, with or without disclosing their identities. The questionnaire was designed to obtain sufficient and relevant information from the respondents. The primary data contained information extracted from the questionnaires in which the respondents were required to give specific answer to a question by ticking in front of an appropriate answer and administered the same on staff of the two organizations: The questionnaires contained structured questions which were divided into sections A and B.

* 1. **Validation of the research instrument**

The questionnaire used as the research instrument was subjected to face its validation. This research instrument (questionnaire) adopted was adequately checked and validated by the supervisor his contributions and corrections were included into the final draft of the research instrument used.

* 1. **Method of data analysis**

The data collected was not an end in itself but it served as a means to an end. The end being the use of the required data to understand the various situations it is with a view to making valuable recommendations and contributions. To this end, the data collected has to be analysis for any meaningful interpretation to come out with some results. It is for this reason that the following methods were adopted in the research project for the analysis of the data collected. For a comprehensive analysis of data collected, emphasis was laid on the use of absolute numbers frequencies of responses and percentages. Answers to the research questions were provided through the comparison of the percentage of workers response to each statement in the questionnaire related to any specified question being considered.

Frequency in this study refers to the arrangement of responses in order of magnitude or occurrence while percentage refers to the arrangements of the responses in order of their proportion. The simple percentage method is believed to be straight forward easy to interpret and understand method.

The researcher therefore chooses the simple percentage as the method to use.

The formula for percentage is shown as.

% = f/N x 100/1

Where f = frequency of respondents response

N = Total Number of response of the sample

100 = Consistency in the percentage of respondents for each item

Contained in questions

**CHAPTER FOUR**

**PRESENTATION ANALYSIS INTERPRETATION OF DATA**

**4.1 Introduction**

Efforts will be made at this stage to present, analyze and interpret the data collected during the field survey. This presentation will be based on the responses from the completed questionnaires. The result of this exercise will be summarized in tabular forms for easy references and analysis. It will also show answers to questions relating to the research questions for this research study. The researcher employed simple percentage in the analysis.

**DATA ANALYSIS**

The data collected from the respondents were analyzed in tabular form with simple percentage for easy understanding.

A total of 133(one hundred and thirty three) questionnaires were distributed and 133 questionnaires were returned.

Question 1

Gender distribution of the respondents.

TABLE I

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Gender distribution of the respondents** | | | | | |
| Response | | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Male | 77 | 57.9 | 57.9 | 57.9 |
| Female | 56 | 42.1 | 42.1 | 100.0 |
| Total | 133 | 100.0 | 100.0 |  |

From the above table it shows that 57.9% of the respondents were male while 42.1% of the respondents were female.

Question 2

The positions held by respondents

TABLE II

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **The positions held by respondents** | | | | | |
| Response | | Frequency | Percent | Valid Percent | Cumulative Percent |
| **Valid** | HRMS | 37 | 27.8 | 27.8 | 27.8 |
| Accountants | 50 | 37.6 | 37.6 | 65.4 |
| Customer care officers | 23 | 17.3 | 17.3 | 82.7 |
| Junior staff | 23 | 17.3 | 17.3 | 100.0 |
| Total | 133 | 100.0 | 100.0 |  |

The above tables shown that 37 respondents which represents27.8% of the respondents are human resource manager respondents which represents 37.6 % are accountants 23 respondents which represents 17.3% of the respondents are customer care officers, while 23 respondents which represent 17.3% of the respondents are junior staff

**TEST OF HYPOTHESES**

The lack of a good internal control is not a major cause of fraud in banks.  **Table III**

|  |  |  |  |
| --- | --- | --- | --- |
| **The lack of a good internal control is not a major cause of fraud in banks.** | | | |
| Response | Observed N | Expected N | Residual |
| Agreed | 40 | 33.3 | 6.8 |
| strongly agreed | 50 | 33.3 | 16.8 |
| Disagreed | 26 | 33.3 | -7.3 |
| strongly disagreed | 17 | 33.3 | -16.3 |
| Total | 133 |  |  |

|  |  |
| --- | --- |
| **Test Statistics** | |
|  | The lack of a good internal control is not a major cause of fraud in banks. |
| Chi-Square | 19.331a |
| Df | 3 |
| Asymp. Sig. | .000 |
| a. 0 cells (0.0%) have expected frequencies less than 5. The minimum expected cell frequency is 33.3. | |

Decision rule:

There researcher therefore reject the null hypothesis the lack of a good internal control is not a major cause of fraud in banks as the calculated value of 19.331 is greater than the critical value of 7.82

Therefore the alternate hypothesis is accepted that the lack of a good internal control is a major cause of fraud in banks.

**TEST OF HYPOTHESIS TWO**

Banks with internal control system cannot prevent the menace of fraud in Nigeria.

Table V

|  |  |  |  |
| --- | --- | --- | --- |
| **Banks with internal control system cannot prevent the menace of fraud in Nigeria.** | | | |
| Response | Observed N | Expected N | Residual |
| Yes | 73 | 44.3 | 28.7 |
| No | 33 | 44.3 | -11.3 |
| Undecided | 27 | 44.3 | -17.3 |
| Total | 133 |  |  |

|  |  |
| --- | --- |
| **Test Statistics** | |
|  | Banks with internal control system cannot prevent the menace of fraud in Nigeria. |
| Chi-Square | 28.211a |
| Df | 2 |
| Asymp. Sig. | .000 |
| a. 0 cells (0.0%) have expected frequencies less than 5. The minimum expected cell frequency is 44.3. | |

Decision rule:

There researcher therefore rejects the null hypothesis Banks with internal control system cannot prevent the menace of fraud in Nigeria as the calculated value of 28.211 is greater than the critical value of 5.99

Therefore the alternate hypothesis is accepted that state Banks with internal control system can prevent the menace of fraud in Nigeria.

**CHAPTER FIVE**

**SUMMARY, CONCLUSION AND RECOMMENDATION**

**5.1 Introduction**

It is important to ascertain that the objective of this study was to ascertain internal control system and bank fraud prevention in Nigeria banking industry. In the preceding chapter, the relevant data collected for this study were presented, critically analyzed and appropriate interpretation given. In this chapter, certain recommendations made which in the opinion of the researcher will be of benefits in addressing the challenges of internal control system and bank fraud prevention in Nigeria banking industry

* 1. **Summary**

This study was on internal control system and bank fraud prevention in Nigeria banking industry. Four objectives were raised which included: To determine if lack of good internal control a major cause of fraud in bank, to ascertain whether banks with internal control system prevent menace of frauds in Nigeria, to determine if bank personnel commit fraud, to ascertain how effectively fraud control measure is in Nigerian banks. In line with these objectives, two research hypotheses were formulated and two null hypotheses were posited. The total population for the study is 200 staff of CBN, Abuja. The researcher used questionnaires as the instrument for the data collection. Descriptive Survey research design was adopted for this study. A total of 133 respondents made human resource management, accountants, customer care officers and junior staff were used for the study. The data collected were presented in tables and analyzed using simple percentages and frequencies

**5.3 Conclusion**

Related to the above is the fact that fraud will be difficult to eradicate completely. It is not surprising therefore that while several hundreds of bank executives and other staff are being incarcerated and imprisoned for fraud, others are busy planning and executing it; this is evident in the sharp rise in fraudulent acts in 2001-2010 as seen earlier, while several thousands are being dismissed on account of fraud, others who read the reports are coming up with newer, more sophisticated ideas to commit the very crime as well as the ever-tightening control measures being instituted by banks are being over-ridden daily, sometimes even by those who instituted them. Since fraud cannot be totally eradicated, then there is need to find ways of minimizing it.

**5.4 Recommendation**

**Adequate remuneration and motivation Banks**

Should strive to remunerate their workers adequately to enable them to meet their basic needs, ensuring that they pay competitive salaries. This should serve as appropriate motivator, alongside other welfare issues such as promotion, giving staffers a sense of belonging so as to prevent segregation or alienation.

**Exemplary leadership**

Bank's management should exhibit exemplary leadership and conducts that do not encourage fraudulent activities. This is in line with the views of Asukwo (1991) and Oyeyiola, (1996), that the top management holds fiduciary duty to act honestly and with utmost good faith, and exercise of skill and care in discharging the statutory obligations of the bank. The board has collective responsibility of the members to ensure that suitable security systems exist, there are adequate accounting records and facilitate the discovery of any falsification.

**Implementation of relevant legislation**

Government should ensure relevant agencies such as Central Bank of Nigeria (CBN), Nigeria Deposit Insurance Corporation (NDIC), National Drug Law Enforcement Agency (NDLEA), Economic and Financial Crimes Commission (EFCC) carry out their duties with minimum interference (Nwaze, 2011). Banking laws relating to fraudulent and other illegal acts should be implemented to the letter; devoid of favouritism or selectivity as was alleged in the implementation of the Failed Bank Decree

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**QUESTIONNAIRE**

**INSTRUCTION**

Please tick or fill in where necessary as the case may be.

Section A

1. Gender of respondent

A male { }

B female { }

1. Age distribution of respondents
2. 15-20 { }
3. 21-30 { }
4. 31-40 { }
5. 41-50 { }
6. 51 and above { }
7. Marital status of respondents?
8. married [ ]
9. single [ ]
10. divorce [ ]
11. Educational qualification off respondents
12. SSCE/OND { }
13. HND/BSC { }
14. PGD/MSC { }
15. PHD { }

Others……………………………….

1. How long have you been in CBN
2. 0-2 years { }
3. 3-5 years { }
4. 6-11 years { }
5. 11 years and above……….
6. Position held by the respondent in CBN
7. HRM { }
8. Accountant { }
9. Customer care officers { }
10. marketer { }
11. How long have you been in CBN
12. 0-2 years { }
13. 3-5 years { }
14. 6-11 years { }
15. 11 years and above……….

SECTION B

1. There is no internal control system in bank?
2. Agrees { }
3. Strongly agreed { }
4. Disagreed { }
5. Strongly disagreed { }
6. There is no prevention of bank fraud in Nigeria banks?

(a) Agrees { }

(b) Strongly agreed { }

(c) Disagreed { }

(d) Strongly disagreed { }

1. There isan effectively is fraud control measure in Nigeria banks performance
2. Agreed { }
3. Strongly agreed { }
4. Disagreed { }
5. Strongly disagreed { }
6. bank personnel commit fraud
7. Agreed { }
8. Strongly agreed { }
9. Disagreed { }
10. Strongly disagreed { }
11. Banks with internal control system prevent menace of frauds in Nigeria.
12. Agreed { }
13. Strongly agreed { }
14. Disagreed { }
15. Strongly disagreed { }
16. Lack of good internal control a major cause of fraud in banks.
17. Agreed { }
18. Strongly agreed { }
19. Disagreed { }
20. Strongly disagreed { }
21. Banks with internal control system cannot prevent the menace of fraud in Nigeria.
22. Agreed { }
23. Strongly agreed { }
24. Disagreed { }
25. Strongly disagreed { }
26. There are causes of bank fraud?
27. Agreed { }
28. Strongly agreed { }
29. Disagreed { }
30. Strongly disagreed { }
31. Both internal and external system cannot control bank fraud?
32. Agreed { }
33. Strongly agreed { }
34. Disagreed { }
35. Strongly disagreed { }