



Internal Control System and Fraud Prevention in Nigerian Deposit Money Banks

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ABSTRACT

Financial institutions worldwide have been characterized by high level of fraudulent activities arising from weaknesses in the internal control processes that have been put in place in the financial organizations to help achieve the set goals and objectives. This paper investigated the influence and effect of the internal control system on fraud prevention in Nigeria deposit money banks by testing selected components of the internal control system against fraud prevention in these institutions. The study made use of the survey design to obtain the data through a structured questionnaire administered to employees of selected deposit money banks in Nigeria. The result revealed that control environment ($\beta = -0.181$, $P = 0.000$) and information and communication ($\beta = 0.964$, $P = 0.000$), proxies of internal control system significantly influences fraud prevention while risk assessment ($\beta = -0.123$, $P = 0.054$) of internal control shows a negative impact on fraud prevention. The study concludes that information and communication of internal control as well as control activities of the internal control system significantly influences fraud prevention in the institutions while risk assessment does not show a positive effect on fraud prevention.

Keywords: Internal Control Mechanisms, Fraud Prevention, Deposit Money Banks, Nigeria

JEL Classifications: M42, K42, G21, O55

1. INTRODUCTION

The internal control system plays a pivotal role in the development of policies in institutions across the world, which can also be a very vital tool in the prevention of fraudulent activities in financial institutions in the economy. A sound internal control system helps an organization to detect, alongside preventing frauds, errors and minimize wastage (Haladu, 2018). The losses caused by fraudulent activities in the financial institution in turn have detrimental and negative impacts on the organizations as it affects the organization's stated goals and objectives, Fraudulent acts in financial institutions have often occurred, there have even been some financial institutions who try to clarify related to the frauds (Pradesyah et al., 2021). Fraud causes distress and losses to the organization which include and not limited to financial, psychological and social losses (Nyakarimi et al.,

2020). Successful fraudulent activities cause numerous damages of diverse kinds, if the financial institutions in an economy are consistently affected by fraudulent activities, it will also directly have an impact on the society or the economy as a whole as the financial institutions are seen as the backbone and stronghold of the society. Fraud is part and parcel of a cancerous threat that negatively affects the growth and development of any nation which should not be underestimated globally.

Regardless of size, profitability, or industry, organizations currently face severe challenges concerning economic and operational sustainability in the wake of deliberate and unethical fraudulent acts (Alfordy, 2022). The rate and volume of fraud in Nigerian banking sector is high and has far reaching consequences as failure of a bank with wide spread of branches affects many people and economy hence there is the need to evaluate the contribution of

internal control to fraud control in banks (Ugwu and Ochuba, 2021).

Despite some studies alluding to the significance of internal control in reducing fraud within organizations, other studies have point out weaknesses in internal controls, resulting in more fraud (Abei, 2021). Many businesses manipulate financial statements to raise more capital from investors and financial institutions, which reduces the practicality of financial statements (Yuh et al., 2019). Past cases of fraudulent activities have created the need to institute as well as encourage an effective internal control mechanism, an example is a case of Cadbury (Nig) Plc in Nigeria where the company's profit was overstated by a total estimate of thirteen billion naira from the year 2003-2006. There is also the case of Afribank in 2011 in Nigeria where the former chief executive officer of the bank was tried for alleged fraud along six others for having to receive stolen property as well as stealing the sum of eighty-seven billion naira belonging to the bank, the Central Bank of Nigeria revoked the bank's license in 2011 while the Federal High Court ordered the winding up of the bank in 2012. Ineffective internal control in the form of heavy reliance on manual operations, poor supervision, improper documentation, the manager's negligence of operational checks, poor communication of specification of functions, and poor systems update results in fraud opportunity (Yolanda, 2021).

The main objective of of this research paper was to examine extent selected components of internal control (control environment, information and communication and risk assessment) and how it influences the prevention of fraud among Nigeria deposit money banks. The study identified two gaps in research, firstly, the literature highlights and expands on the relationship on the effect and impact of internal control system on fraud prevention in deposit money banks.

Secondly, there have been few studies on the influence of firm age and firm size on the relationship between internal control system and fraud prevention in deposit money banks. Therefore, the research aims to evaluate if the internal control system in deposit money banks has any influence on fraud prevention in the institutions, this is done by measuring three components of internal control against fraud prevention. The paper suggests the following hypotheses:

- H₁: Information and communication of internal control does not significantly influence fraud prevention in deposit money banks.
- H₂: Control environment of internal control does not significantly influence fraud prevention in deposit money banks.
- H₃: Risk assessment of internal control does not significantly influence fraud prevention in deposit money banks.

2. LITERATURE REVIEW

Researchers have sought to describe different views and perceptions of fraud in institutions. Standard practices such as a combination of prevention and detection tools, will minimize the risks associated with fraud and make vulnerable organizational structures stronger and resistant to fraud tactics (Riney, 2018) Extant literature has identified critical factors that could lead to fraudulent activities, (which may either be opportunity, rationalization and perceived Pressure) along with the function

of internal control as well as its influence on fraud prevention in financial institutions.

The consistent occurrence of fraudulent activities and weaknesses in internal control have been a major contribution to the financial distress of most financial institutions as well as their poor performances. Oyerogba (2021), revealed in his research that forensic auditor skills and techniques is a significant predictor for fraud detection in the Nigerian public sector. Research carried out by Suh et al. (2019) attempted to measure the relationships between the perceived "opportunity reduction" and other fraud risk factors with regard to the "likelihood of fraud occurrence" in financial institutions. The evaluative analysis of this study revealed that "the qualitative side of opportunity reduction through the perceived effectiveness of anti-fraud controls is negatively associated with the odds of reporting a historic occurrence of occupational fraud, whilst the quantitative angle of opportunity reduction (the number of anti-fraud controls) is not" (Suh et al., 2019). The research work revealed that elimination of perceived opportunity was significantly linked with the decrease in fraud occurrence in institutions. The research work provided statistical evidence that the reduction in perceived opportunity is negatively associated with the odds of the employee reporting the occurrence of occupational fraud in the organization, the study concludes that counter-fraud effort and activity should focus on eliminating fraud opportunities by combining prevention and deterrence measures (Suh et al., 2019).

A research work conducted by Yolanda (2021) investigated impact of internal control on fraud detection and prevention in Micro-finance institutions in Cameroon, the result showed that fraud opportunity was caused as a result of some loopholes in the internal control such as poor working environment, poor monitoring, low standard facilities, negligence of operations as well as poor employee recruitment practices. The study shows internal control practices like constant monitoring, fraud training, risk assessment, cash reconciliation, and use of passwords, could reduce the fraud opportunity (Abei, 2021).

Kabue and Aduda, (2017) investigated the effect of internal controls on fraud prevention among commercial banks in Kenya, where he adopted explanatory research design while using the primary data as the source of data collection. The result indicated there was a negative and significant relationship between reconciliation control and level of fraud prevention. A research carried out by Cross (2020) in Australia examined how accountability relates to fraud victimization. Purpose of research was investigate general narrative that discern way wherein responsibility is recognized and the conflict between assigning blame. Analysis showed a high amount of any disagreement over who should be held responsible for fraud, including the perpetrator, the victim, and third parties. Findings of research clearly indicated accountability is not controlled by any one party, instead there seems to be a relationship between victims, perpetrators and third parties.

2.1. Control Environment of Internal Control and Fraud Prevention

Most sectors across the country have become vulnerable to financial fraud which could be due to economic hardships,

financial scandals and poor structures against fraud. Control environment is the set of standards, processes, and structures that provide the basis for carrying out internal control across the organization (Mulugeta, 2021). Research by Ugwu and Ochuba (2021) investigated internal control as a tool for fraud control in deposit money banks in Nigeria, the study adopted survey research design. The test of hypothesis revealed control environment has significant contribution towards fraud control in deposit money banks in Nigeria, from the research, it was concluded that the internal control can be used as an effective tool for fraud control in deposit money banks in Nigeria (Ugwu and Ochuba, 2021).

Mohammed and Kabir (2021) studied internal control system effectiveness and fraud prevention in deposit money banks in Nigeria, the aim of the study was to examine internal control system effectiveness and fraud prevention in deposit money banks. The findings of the study showed that there was a positive and significant relationship between control environment and fraud prevention mechanism, the overall result showed that control environment, risk assessment as well as information and communication of internal control have a positive and significant impact on fraud prevention (Evelyn et al., 2021). Nyakarimi et al., (2015) investigated internal control system as means of fraud control in deposit taking financial institutions in Imenti North Sub-County, the purpose of the study was to establish the relationship between internal control system and fraud control in deposit taking financial institutions. The study found that the financial institutions analyzed result through vetting on competencies and integrity, the organization structure reflects chain of command, there are proper follow-up of delegated responsibilities and the employees are promoted and compensated fairly.

2.2. Information and Communication of Internal Control System and Fraud Prevention

Fraud is criminal and carefully planned deceit of the users of the information for the eventual gain of the producer (Ugwu and Ochuba, 2021). Information and communication are systems or processes that support the identification, capture, and exchange of information in a form and period that enables people to carry out their responsibilities (Haladu, 2018). A research work conducted by Nyakarimi et al. (2020) investigated application of the internal control system on fraud prevention in the banking sector, the objective was to establish the effect of internal control system on fraud prevention in the banking sector. Test results showed control environment of internal control had no significant effect on fraud prevention in the banking sector, the study's hypothesis test revealed information and communication of the internal control system had a significant effect on the prevention of fraud, the result showed that the control mechanisms the organization put in place pertaining to communication of information were working appropriately and has a significant effect on fraud prevention (Nyakarimi et al., 2020). Therefore, it was concluded that the mechanisms put in place were not capable of preventing the occurrence of fraud, the parameters were not strong enough based on the findings to address issues of fraud prevention completely.

Mulugeta (2021) investigated the effectiveness of internal control system for detection and prevention of fraud in deposit money banks,

the study revealed fraud occurs mostly by bank employees who have knowledge of the systems alongside classified and confidential information together with the external bodies mostly the customer of the banks. The result also showed information and communication and risk assessment were effective in fraud detection and prevention in Ethiopian banking sectors. Based on findings of the research, it was concluded that risk assessment as well as information and communication of internal control had a positive and statistically significant impact on fraud detection and prevention.

2.3. Risk Assessment of Internal Control and Fraud Prevention

The issue and frequent occurrence of fraudulent activities have led to many losses in financial institutions among which loss of reputation and loss of public confidence are all included. Haladu (2018) studied fraud detection and internal control measures in deposit money banks, it was concluded in the study that the deposit money banks had invested so much on internal control systems that had not help them reduce fraud in the institution. The study also showed that the internal control measures put in place on control environment and risk assessment had a negative effect on fraud detection and prevention on the institutions. The study concluded that the internal control systems of deposit money banks in Nigeria were inefficient and ineffective.

A plan is always carried out before committing a fraud, fraud is always intentional or deliberate, a person does not commit fraud by accident, Ilugbusi (2020) studied Impact of internal control on fraud prevention in deposit money banks. The study adopted a descriptive survey research design, the descriptive statistics was adopted as the statistical tool for the study which included percentages, tables and frequency distribution. The result revealed that internal control proxies adopted for the research (risk assessment, information and communication) were significant on fraud prevention among the institutions, the study recommends that if deposit money banks could review the human resource management functions periodically, it will help reduce the loop holes for fraudulent activities performed among staffs of the institutions (Ilugbusi, 2020).

Research conducted by Rashid (2022) evaluated the role of internal control in fraud prevention and detection, It was found that the risk assessment agency is the most important for fraud prevention among deposit banks in Nigeria because it has the highest beta. Fasua et al. (2016) mentioned that fraud prevention can be achieved through positive modeling and labeling of tone at the top and if other elements of fraud can be dealt with.

3. METHODOLOGY

3.1. Research Design, Data and Sample Description

The study made use of descriptive research design while utilizing the quantitative methods. Survey research design was used to

Table 1: Distribution and response rate

Questionnaire	Frequency	Percent
Copies retained	214	76.4
Copies discarded	66	23.6
Total copies administered	280	100

Table 2: Demographic profile

Variables	Categories	Frequency	Percent
Gender	Female	112	52.3
	Male	102	47.7
	Total	214	100.0
Age group	25 and below	36	16.8
	26-35	96	44.9
	36-45	76	35.5
	46-55	6	2.8
	Total	214	100.0
Length of service in institution	Below 1 year	42	19.6
	1-5 years	68	31.8
	11-15 years	27	12.6
	6-10 years	53	24.8
	Above 15 years	24	11.2
	Total	214	100.0
Educational level	Diploma	11	5.2
	Degree	127	59.3
	Masters and above	76	35.5
	Total	214	100.0

Table 3: Regression results of study variables

Constructs	Unstandardized β	T-statistic	P-value
(Constant)	0.934	5.967	0.000
ICA	0.964	17.034	0.000**
CE	-0.181	-4.614	0.000**
RA	0.123	1.935	0.054*

**(Significant at 5%)

Table 4: Model summary

Tests	Value
R	0.851
R ²	0.725
Adjusted R ²	0.719
F statistic _(4, 209)	137.584 (P=0.000)

obtain information used for the study, as it provided the privilege of collection of data about a population that is too large to be observed directly.

The population comprise of 24 deposit money banks in Nigeria. The sample size from the deposit money banks were deposit money banks issued with the banking license of international authorization; the entire eight banks were selected for the research. A sample of 280 respondents were determined using the Taro Yamane formula. A total of 214 (76.4%) responses were obtained and the remaining 66 (23.6%) were discarded due to some that were not returned and some that had incomplete information (Table 1).

The survey used a five-point Likert scale from strongly agree (5), Agree (4), Neutral (3), Disagree (2) and strongly disagree (1).

3.2. Model Specification and Measurement of Variables

The economic model for achieving the objective is presented by:

$$FP = F\beta_0 + \beta_1 X1_{it} + \beta_2 X2_{it} + \beta_3 X3_{it} + e_{it}$$

Where FP = Fraud Prevention, X1= Control environment, X2 = Risk assessment, X3 = Information and communication. β_0 is constant or coefficient of intercept while β_1 , β_2 , and β_3 , are corresponding coefficients for the respective independent variable which measures the change in the mean value of FP, per unit change in their respective independent variables. e = error term which is assumed to be normally distributed with mean zero and constant variance.

4. RESULTS AND DISCUSSION

4.1. Diagnostic Results

The research instrument was tested for reliability using the Cronbach's alpha. Cronbach's alpha values for the study constructs were; risk assessment = 0.877, Control environment = 0.718 while Information and communication = 0.818. Cronbach's alpha values of all of the constructs were above the threshold of 0.7 and it is therefore suitable for achieving the study's objective.

4.2. Demographic Profile of Respondents

Table 2 shows the demographic characteristics of the respondents. The results show the study's respondents were spread across the different age brackets.

4.3. Regression Results

Table 3 presents the regression results of the study's model, the result showed that Internal control system had a positive effect on fraud prevention in deposit money banks in Nigeria and found that risk assessment ($\beta = -0.123$, $P = 0.054$) did not significantly predict fraud prevention. Nevertheless, information and communication activities ($\beta = 0.964$, $P = 0.000$) and control environment ($\beta = -0.181$, $P = 0.000$) significantly predicts fraud prevention in deposit money banks. Table 4 shows the regression result showing the coefficient of determination (R^2) and the F statistics.

The null hypotheses H_1 and H_2 is rejected while the null hypotheses H_3 is accepted as the result of the findings revealed that information and communication of internal control as well as the control environment component have a positive effect on fraud prevention in deposit money banks while risk assessment does not show a positive effect on fraud prevention.

4.4. Discussion

The study investigated the internal control system in deposit money banks in Nigeria as well as the relationship and influence on fraud prevention in the institutions. The hypotheses were tested using the ordinary least square (OLS) regression model while a 5% significance level was adopted.

The findings revealed that there is a significant relationship between internal control system and fraud prevention in the institutions, according to the result, the first hypotheses (H_1) as well as the second hypotheses (H_2) were rejected: thus, information and communication of internal control significantly influences fraud prevention as well as control activities of internal control which also significantly influences fraud prevention in deposit money banks in Nigeria. The third hypothesis was accepted which

shows risk assessment component of internal control does not significantly influence fraud prevention in deposit money banks.

The findings were in line with Alhassan (2018), who established that risk assessment does not significantly influence fraud prevention and detection in deposit money banks in Nigeria while control environment had a significant influence on the deposit money banks, it was concluded that the control measures put in place by deposit money banks aggravates rather than curb the problem of fraud detection and prevention (Alhassan, 2018).

The result of the findings is also in line with Nyakarimi et al. (2020) who established that information and communication of internal control have significant effect on fraud in financial institutions. The findings from the research contradict the findings of Mulugeta (2021) who concluded that control environment of internal control is statistically insignificant in preventing fraud in the banking sector based on the findings and does not have a cause or effect on the relationship between fraud prevention.

5. CONCLUSION

This paper investigated the relationship between internal control system and fraud prevention in deposit money banks in Nigeria. It aimed to specifically observe the extent the selected components of internal control (control environment, risk assessment and information and communication) could influence fraud prevention in deposit money banks.

The paper concludes that information and communication of internal control as well as control activities of the internal control system significantly influences fraud prevention in the institutions while risk assessment showed a negative effect. The study recommends that deposit money banks in Nigeria should work on strengthening other components as they may be deemed weak against the prevention of fraud in the institutions. They are also encouraged to pay very close attention to their communication and information management systems within the institution, as to enable all parties within the institution to freely access and utilize necessary official information that will enable the employees to embrace and appreciate their roles in enhancing vigilance against fraudsters.

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