DETERMINANTS OF OCCUPATIONAL FRAUD IN COMMERCIAL BANKS IN KENYA

BY

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DECLARATION

This research project is my original work and has not been presented for examination in any other university.

Signed.. Date 07/11/12 ....

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This research project has been submitted for examination with my approval as the candidate's University Supervisor.

Signed .... Date 8/11/2012 ....

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DEDICATION

I dedicate this work to my beloved children Ivy and Ian Gatheru.

ABSTRACT

Kenya has the highest occupational fraud incidences in the world. The incidence of occupational fraud is 66%, nearly twice the global average of 34% and above the average occupational fraud incidence in Africa of 57% (PwC, 2011). The main objective of the study was to assess the determinants affecting occupational fraud in commercial banks in Kenya.

The study adopted a descriptive survey design. The population of this study was all the commercial banks in Kenya. There are forty three commercial banks in Kenya and this is the group from which the sample was drawn. Simple random sampling method was used where the researcher will sample 1 top manager, 2 middle level managers and 3 low level management staff from each institution – giving the study a sample population of 258 respondents from the target population.

The researcher developed the instruments with which to collect the necessary information. Questionnaires were used to obtain important information about the population. The research was carried out using primary and secondary data. The study concludes that given the right pressure, opportunities, and rationalizations, every employee is capable of committing fraud; and that characteristics of bank employees affect occupational fraud to a low extent;

The study recommends the organizations to train their employees to adopt a right attitude and work towards stress management to minimize occupational fraud. They should also have a self drive to perform, avoid overspending, and also do away with desire for gain to minimize occupational fraud. They should put in place a system to deal with staff grievances as this will to a great extent minimize occupational fraud. The study also discourages closeness of customers to bank employees as it has been reported to lead to operational fraud to a moderate extent.

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LIST OF ABREVIATIONS

ACFE	Association of Certified Fraud Examiners
AICPA	American Institute of Certified Public Accountants
CBK	Central Bank of Kenya
COSO	Committee of Sponsoring Organizations of the Treadway Commission
FDI	Foreign Direct Investments
GCI	Global Competitive Index
ROK	Republic of Kenya
IIA	Institute of Internal Auditors
ISA	International Standards on Auditing
KPMG	Klynveld Peat Marwick Goerdeler
PWC	PricewaterhouseCoopers
SEC	Securities and Exchange Commission
SPSS	Statistical Package for Social Sciences
MLRO	Money Laundering Reporting Officer

CHAPTER ONE

INTRODUCTION

1.1 Background of the study

1.1.1 Occupational Fraud

The term fraud has come to encompass many forms of misconducts. Although the legal definition of fraud is very specific, for most people, the common usage is much broader and generally covers any attempt to deceive another party to gain a benefit. Fraud is defined by the International Standards on Auditing (ISA No. 240), as an intentional act by one or more individuals among management, employees, or third parties, which results in a misrepresentation of financial statements. Concise English dictionary defines fraud as an act of deceit, scam, con, cheat, hoax, scandal by means of false representation to obtain an unjust advantage. Occupational fraud can be defined as the use of one's occupation for personal enrichment through the deliberate misuse or misappropriation of the employing organization's resources or assets.

Fraud is believed to be amongst the most serious corporate problems, and challenges in today's business environment. It is a dominant white collar crime in today's business environment where many businesses and government organisations, particularly in financial and related services, suffer from fraud of various kinds. In the banking industry, many frauds are perpetrated through falsified payment instruments. Common fraud types include; Cheque fraud, computer fraud, Card fraud and Mail order fraud that's commonly referred to as internet fraud.

The phenomenon is empirically supported by a number of studies; for example, Cain (1999) and the KPMG Australia fraud survey (KPMG, 2002) each indicate that over 50 per cent of all respondents surveyed believed that fraud is a major business problem. Similarly, reviews of fraud cases by Rezaee (2004) revealed that financial statement fraud has cost market participants more than $500 billion during recent years, with serious litigation consequences for associated auditors.

Fraud can be perpetrated on organisation both from outside – the external threat – and from within. Organisations can be set up for the principal purpose of defrauding others and, using the agency of a limited company; fraudsters can perpetrate serious economic offences shielding themselves behind the veil of incorporation. Fraud is now the crime of choice of organised criminal gangs worldwide. The likely gains are enormous and the likelihood of apprehension and thus of conviction and punishment comparatively small compared with conventional crimes of dishonesty involving guns, intimidation and violence of all kinds. Professional criminals are targeting big business.

The risks of fraud within and upon corporations cannot be understated. They include the immediate risks to the company affected, which can fail completely. There is also the reputation risk to the company that has suffered major fraud. This is one reason that companies and particularly financial houses are so reluctant to report fraud to law enforcement, where they fear that the likelihood of their names hitting the headlines associated with major losses will result in competitors' obtaining an advantage and customers walking away. Systemic risk that affects an entire financial market cannot be underestimated. After the banking crisis in the 1980s, where so many minor financial houses failed, largely as a result of fraud, confidence in the banking sector was shaken severely.

A possible strategy for auditors in light of this problem is to assess the likelihood of fraud. The ability of an auditor to accurately assess the risk of fraud is crucial to the initial assessment of risk of material misstatement during the planning stage of the audit. The risk assessment will affect the design of audit tests. Incorrect assessment of risk may result in either inefficient or ineffective audit.

1.1.2 Commercial Banks in Kenya

A commercial bank is a type of a financial intermediary. Commercial banking is also referred to as business banking. It is a bank that provides current accounts, savings accounts, and money market accounts and that accepts time deposits. Commercial banking also refers to a bank or a division in a bank that primarily deals with deposits and loans from corporations or large businesses. It can also be viewed as distinct from retail banking, which involves providing financial services directly to consumers. Many banks are involved in both commercial and retail banking services (CBK, 2008).

There are forty three banks as categorized by Central Bank and members of the clearing house. Thirty-five of these banks, most of which are small to medium sized, are locally owned. The industry is mostly dominated by a few large banks which are foreign-owned, though some are partially locally owned. Six of these major banks have been listed on the Nairobi Stock Exchange. The banks came together under the Kenya Bankers Association (KBA), which serves as the lobby for banks' interests and addresses the issues affecting member institutions (Kenya Bankers Association Annual Report, 2008). The commercial banks and non-banking financial institutions offer corporate and retail banking services but a smaller number, mainly comprising the larger banks, offer other services including investment banking.

Banks represent a significant and influential sector of business worldwide that plays a crucial role in the global economy. Commercial banks are financial Closeness of Customers to Bank Employees that serve as financial resource mobilization points in the global economy. They channel funds needed by business and household sectors from surplus spending to deficit spending units in the economy (Johnson & Johnson, 1985). A well-developed efficient banking sector is an important prerequisite for saving and investment decisions needed for rapid economic growth. A well-functioning banking sector provides a system by which a country's most profitable and efficient projects are systematically and continuously funded. The role of banks in an economy is paramount because they execute monetary policy and provide means for facilitating payment for goods and services in the domestic and international trade.

1.2 Statement of the problem

Kenya has the highest occupational fraud incidences in the world (PwC, 2011). The incidence of occupational fraud is 66%, nearly twice the global average of 34% and above the average occupational fraud incidence in Africa of 57% (PwC, 2011). Globally, Commercial banks are the most vulnerable to occupational fraud, ranking number one in a list of 22 industries (ACFE, 2010). Kenya ranks number 26 out of 142 countries in financial development in Global Competitive Index (GCI, 2010), ahead of Uganda number 66 and Tanzania 85. Despite the banking sector in Kenya ranking of other countries in East Africa, economic crime survey indicate that incidences of occupational fraud have soared sharply compared to previous years with more than 90% (39) of the commercial banks in Kenya being affected within the year 2010 (PwC, 2011). Financial Services Survey, a report by PriceWaterhouseCoopers indicates that Commercial Banks in Kenya are more susceptible to fraud risk than her neighbour countries in East Africa (PwC, 2010).

Fraud risks continue to pose a threat to Commercial Banks' role of financial intermediation and supporting economic growth in Kenya as postulated in the Vision 2010. The rising rate of the vice continues to erode investor and consumer confidence and pose a threat to potential investors in Kenya (PwC, 2011). Forty-two percent of occupational frauds were committed by employees, as compared to 38.6% for managers and 19.3% for owners/executives (ACFE, 2006)

Empirical studies (Baker, 2003; Duffield & Grabosky, 2001; Zahra, 2005; Mustafa & Youssef, 2010) have concentrated on the causes and motivations of defrauding by staff. Other scholars (Alleyne & Howard, 2002; Bakre, 2007; Brazel et al, 2007; Hammersley, Bamber & Carpenter, 2007; Lange, 2008; Owusu & Ansah, 2002) studied the role of external auditors in fraud detection and prevention and they produced conflicting findings. Some of the fraud risk studies that incorporated technology and its role in fraud risk management include (Baker, 2003; Grazioli & Jarvempaa, 2003; Haugen & Selin, 1999; MacInnes et al, 2005; Nikitkov & Bay, 2008).

From the reviewed empirical literature, it is evident that there is hardly any empirical study on occupational fraud in Commercial Banks in Kenya. This study seeks to assess the determinants affecting occupational fraud in commercial banks in Kenya and contribute to other studies by ascertaining if the selected variables affect occupational fraud in the banking industry in Kenya. The study seeks to do so by answering the following research questions; Do personal characteristics of bank employees affect occupational fraud in commercial Banks in Kenya? How does closeness of customers to bank employees affect occupational fraud in commercial Banks in Kenya? How dofalse financial statements affect occupational fraud in commercial Banks in Kenya?

1.3 Research Objective

The main objective of the study was to assess the determinants affecting occupational fraud in commercial banks in Kenya.

1.4 Value of the Study

i. The study will be of help to the government as it seeks to leverage on regulation to grow the financial services sector and enhance financial access and inclusion.

ii. The study will help banks in occupational fraud risk management and in the development of policies to reduce operational risk within the banking sector. The study will also add value to the existing body of knowledge as it will develop insights of occupational fraud reduction not only in the commercial banks but also the wider market players.

iii. This study will be of invaluable benefits and usefulness to all categories of potential bank clients and users of financial services including existing and potential shareholders, creditors, debtors and fund providers in understanding the susceptibility to bank fraud and how to reduce the same.

iv. The impact of occupational fraud in the operations of commercial banks in Kenya and indeed the economy at large is of interest to researchers and industry practitioners. This study will serve as a stepping stone for new research in occupational fraud. Besides, researchers and students in the field of banking and finance who want to know more about fraud, its causes and possible ways of preventing it, will also find the study beneficial.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter reviews both theoretical and empirical literature on fraud risk management and develops a theoretical framework. A comparison in local context and a summary of the chapter will also be presented.

2.2 Theoretical Review

2.2.1 Concept of Fraud

A wide category of crimes, swindles and employee trust violations fall under the category of fraud (ACFE, 2010). Researchers have defined the concept of occupational fraud differently. Duffield and Grabosky (2001) define fraud as an act involving deceit (such as intentional distortion of the truth or misrepresentation or concealment of a material fact), to gain an unfair advantage over another in order to secure something of value or deprive another of a right.

Fraud can be examined from different perspectives (ACFE, 2010). Fraud can be examined on the view whether the fraud perpetrator is internal or external to the organizational that suffered from the fraudulent acts (ACFE, 2010; Haugen and Selin, 1999). Fraud may also be distinguished by its nature. A joint report by the Institute of Internal Auditors (IIA, 2008), American Institute of Certified Public Accountants (AICPA) and Association of Certified Fraud Examiners (ACFE) offered the following sample fraud risk exposure taxonomy: (1) financial reporting fraud, (2) misappropriation of tangible assets, intangible assets or proprietary business opportunities, and (3) corruption, including bribery, gratuities, money laundering and embezzlement. Levi (2008) has categorized fraud into victim sector and subsectors. ACFE (2010) define occupational fraud as the use of one's occupation for personal enrichment through the deliberate misuse of or misapplication of the employing organization's resources or assets.

Available literature suggests that occupational fraud is not random occurrences (Saksena, 2001; Grabosky, 2001; Bagnoli& Watts, 2010). Instead, various factors contribute to the likelihood of their occurrence, and the form of the occurrence (ACFE, 2010; Langenderfer&Shimp, 2001; Zahra, 2005; Bakre, 2007)

2.2.2 Agency theory

Agency theory provides insight into what reward mix best aligns organizational and individual objectives. It outlines how the separation of organizational activities from ownership presents the problem of ensuring that owners' interests are aligned to those responsible for operating the business (Gamble, 2001). Owners look to ensure that employees direct their work effort in line with the owners' interests. This can be achieved through adjusting the reward mix, in particular the balance between fixed and variable rewards, to ensure that appropriate incentives are in place for the employee to act in the owners' interest (Gamble, 2001). The large body of research on agency theory generally supports its predictions that organizations' can use incentives, alongside monitoring activity, to control employee effort (Klein, 2000).

Agency theory has emerged as the main theoretical explanation of reward mix. However, while the agency research tells us about the fixed to variable reward relationship, it does not incorporate benefits and relational returns. It has also been suggested that the approach overemphasizes efficiency and rational drivers of reward mix determination and underestimates the institutional pressures that may also be relevant (Locke, 2000).

2.2.2 Fraud Triangle Theory

The theory places emphasis on the causes of fraud in institutions. Cressey's (1971) original work in analyzing managers who embezzled from the organizations that employed them found that fraud includes three elements; an unsharable problem, accessibility and control of assets or accounting records, and the ability to bypass or override controls meant to prevent manipulation, pressure, the motivation to commit the fraudulent act, and rationalization as referring to the moral and ethical argument used to justify the act.

While Cressey's (1971) triangular model provides a basis for understanding management fraud, other factors are present in many situations in which managers engage in fraudulent activities. Ludwig and Longenecker (1993) described a phenomenon they termed as the Bathsheba syndrome. Managers and leaders who are increasingly successful often acquire unrestrictive control over the organization and its resources. The Bathsheba syndrome is described as an example of the corrupting influences of power and the willful abuse of authority. Ludwig and Longenecker (1993) suggested that a negative consequence of success is the new ability of managers to rationalize actions they know are unethical. Several studies conducted after large organizational failures have shown higher than anticipated involvement of senior management in covering up or causing decline (COSO, 1987).

The theory is important in that it offers a coherent and logical explanation on the cause of fraud. It further shows that factors that factors that contribute to a success in fraud and the conditions that contribute to this success. The fraud triangle theory is limited in that it is concerned with the causes of fraud but does not demonstrate how the fraud can be assessed, detected and resolved.

2.2.3 The Fraud Management Lifecycle Theory

According to Wesley (2004), fraud management lifecycle is; a network lifecycle where each node in the network, each stage in the lifecycle, is an aggregated entity that is made up of interrelated, interdependent and independent actions, functions and operations. These activities can, but do not necessarily, occur in a sequential or linear flow. The Fraud Management Lifecycle is made up of eight stages; deterrence, prevention, detection, mitigation, analysis, policy, investigation and prosecution. This theory suggests that prosecution, the last stage, is the culmination of all the successes and failures in the Fraud Management Lifecycle. There are failures because the fraud was successful and because the fraud was detected, a suspect identified, apprehended, and charges filed. The prosecution stage includes asset recovery, criminal restitution, and conviction with its attendant deterrent value (Wesley, 2004). The interrelationships among each of these stages (nodes) in the Fraud Management Network are the building blocks of the Fraud Management Lifecycle Theory.

The theory is important in that it is vividly shows the stages of fraud risks management in a sequential manner. The theory also shows what institutional processes should be put in place for fraud to be effectively managed. The theory places a lot of emphasis on how to curb fraud but does not explain drivers of fraud within the Commercial Banks. This theory assumes uniform cultural, legal, and technological applications in the management of fraud. This theory does not attempt to explain nor prescribe fraud management in an environment when such systems and processes fail. It is therefore a more reactive rather than a proactive theory.

2.3 Empirical Review

2.3.1 Characteristics of Bank Employees

In examining the effect of collusion on the size of losses sustained by victim organizations, a study by ACFE (2006) found the results to be quite clear. The survey found that frauds perpetrated by two or more persons are more than eight times larger than those committed by a single individual. This result may be explained by the overall difficulty to detect collusion since it can neutralize the effectiveness of segregation of duties as an anti-fraud control (ACFE, 2006).

Another study by ACFE (2012) found that when two or more individuals conspire to commit fraud against an organization, it can have an especially harmful effect, particularly when the combined efforts of the fraudsters enable them to circumvent or override anti-fraud controls. In our three most recent studies, the rate of collusion (defined as two or more perpetrators engaged in the fraud) has been fairly consistent; multiple perpetrators were reported in 36% to 42% of all cases. Schemes involving collusion have also consistently resulted in much larger losses than those involving a single fraudster (ACFE,2012).

Prior to the cases reported in the above study, 88.9% of the fraudsters in this survey had never been charged or convicted of a fraud-related offense. This indicates that criminal background checks will have limited effectiveness as an anti-fraud measure. Occupational frauds are most commonly perpetrated by employees, (42.0%) with diminishing frequency for managers (38.6%) and owner/executives (19.3%), respectively. These numbers are most likely correlated to the respective numbers of employees, managers and owners/executives present in most organizations, although the percentage of fraud committed by owners/executives is relatively large (ACFE,2012).

A survey by Coenenin 2008 indicated that 92% of people who commit fraud have no prior criminal charges or convictions related to fraud. This, however, does not mean that companies should stop carrying out prior criminal checks before hiring new employees (Coenen 2008). According to a study by Griffith,Fogelberg, & Weeks (2002),occupational fraud and abuse includes a variety of conduct by employees, managers, and principals of organizations. The fraudulent act may range from pilferage to sophisticated investment swindles. They also found that given the right pressures, opportunities, and rationalizations, every employee is capable of committing fraud. The study found the following as the characteristics of fraudulent employees; intelligent, egotistical, inquisitive, risk taker, rule breaker, hard worker, under stress, greedy, financial need, disgruntled or a complainer, big spender, overwhelming desire for personal gain, pressured to perform and having close relationship with vendors/suppliers (Griffith,Fogelberg, & Weeks, 2002).

2.3.2 Closeness of Customers to Bank Employees

In a report to the Nations on occupational fraud and abuse by ACFE (2012), in 81% of cases, the fraudster displayed one or more behavioral red flags that are often associated with fraudulent conduct. Living beyond means (36% of cases), financial difficulties (27%), unusually close association with vendors or customers (19%) and excessive control issues (18%) were the most commonly observed behavioral warning signs (ACFE,2012).

In Urbancic and Hubbard (2003) a study was conducted concerning related party transactions, i.e. transactions with "an affiliate, owner, management, or any other party with which an organization dea ls in situations where one of the parties can influence the management or operation policies of the other". According to the authors, there is an increased likelihood of fraud when one or more of the listed indicators are present in an organization. The indications listed include, for example, shortage of sufficient working capital or credit to continue operations, urgency on the part of management to have a favourable earnings record to support the company's stock-market price, an earnings forecast that is overly optimistic and dependence on one or few products, customers or transactions for the continued success of the company (Urbancic and Hubbard, 2003).

2.3.3 False Financial Statements

The detection of fraud in financial statements has been the subject of much empirical research. Nieschwietz, Schultz &Zimbelman (2000) provide a comprehensive review of empirical studies related to external auditors' detection of fraudulent financial reporting. Albrecht, Albrecht & Dunn (2001)review the fraud detection aspects of current auditing standards and the empirical research conducted on fraud detection. The Committee of Sponsoring Organizations of the Treadway Commission sponsored a descriptive research study by Beasley, Carcello&Hermanson (1999)that provides a comprehensive analysis of fraudulent financial reporting occurrences investigated by the SEC subsequent to the issuance of the 1987 Tread way Commission report.

2.4 Fraud: A Kenyan perspective

Fraud is one of the most significant risks affecting management of financial services in Eastern Africa region. Kenya is relatively advanced in the banking sector and could be expected to be more cautious of the risks of fraud than banks in more nascent markets i.e. Uganda, Tanzania, Rwanda and Zambia (PwC, 2011; World Economic Forum, 2010). Why then does the fraud risk persist and even more in commercial banks in Kenya compared to other Eastern African countries? Fraud is one of the economic crimes in Kenya. Government of Kenya Statistics report an alarming annual 45% average increase in the number of economic crimes (GOK, 2011)

The global economic crime survey, a publication of the PwC (PwC, 2011) report that Kenya has the highest incidences of fraud in the world, based on a global ranking of 78 countries surveyed. In terms of frequency of fraud, "white collar theft" or asset misappropriation is cited as the most common type of economic crime in Kenya followed by accounting fraud, corruption and money laundering. Cybercrime originating from Africa is cited as a worrisome trend and it is ranked as one of the top crimes in Kenya. "The perception of cybercrime as a predominantly external threat is changing and organizations are now recognizing the risk of cybercrime coming from inside as well (PwC, 2011).

The 2010 economic crime survey conducted by PwC (PwC, 2011) indicates that incidences of fraud have soared sharply compared to previous years and further reports that fraud affects all sectors of the Kenyan economy. More than 90% of respondents said that their organizations have been hit by fraud. Commercial banks in Kenya lost a staggering Kshs 1.7 billion in the three months August to October 2010. According to the Central Bank of Kenya (CBK, 2010), commercial banks lost Kshs 761 million in the first six months of 2010 through fraud.

Many medium and large sized organizations have recently incorporated risk management functions to help identify and address fraud. These functions have devoted significant efforts and resources to address internal risk, financial risk, environmental risk, political risks, economic risks and commercial risks. Even so, companies that are growing in size and complexity and implementing multiple technology based systems are at risk of fraud. Financial institutions' top management has delegated supervision to middle management and operational clerks. Internal risk management systems are losing ground to highly networked, sophisticated fraudsters (PwC, 2011).

According to the Global Competitive Index report (2010-2011), Kenya ranked 102 out of the 142 countries with an overall score of 3.7 out of the maximum 7 putting Kenya among the bottom 40 in terms of competitiveness in the world. One of the factors contributing to the bottom 40 in terms of competitiveness is economic crime which accounts for 31.5% of the deterrents of Global Competitiveness, higher than Uganda at 21.5% and Tanzania at 16.8%. The report further indicate that the Kenyan economy is supported by financial markets that are well developed by international standards (27th position) indicating a strong potential for growth of the Kenyan Banking industry and a relatively efficient labour market (46th position). In terms of financial development, Kenya is ranked number 26 out of 142 countries indicating a relatively advanced banking sector that could be expected to be more conscious of operational risks than the lower ranking banking sectors.

The Government of Kenya earmarked the banking sector as one of the key pillars to the achievement of Vision 2030. Vision 2030 is a longer term strategy to achieve sustainable growth by the year 2030 through increased savings, encourage Foreign Direct Investments (FDI), safeguard the economy from external shocks as well as propel Kenya to become a leading financial centre in Eastern and Southern Africa. Within the Medium Term Plan (2008-2012) under Vision 2030, some of the target areas include development of a safe and reliable payment system that will ensure smooth transfer and settlement of funds between customers and banks as well as between banks (ROK, 2008).

2.5 Summary

Occupational fraud leads to loss of money, which belong to either the bank or customers. This may be absorbed by the profits for the affected trading period and this consequently reduces the amount of profit, which would have been available for distribution to shareholders. Losses from occupational fraud which are absorbed to equity capital of the bank impairs the bank's financial health and constraints its ability to extend loans and advances for profitable operations. In extreme cases, rampant and large incidents of fraud lead to a bank's failure. Empirical studies have shown that there is a relationship between commercial bank's financial distress, bank failures and bank fraud (Ayee, 2002; Eseoghene, 2010). Occupational fraud not only erodes the customers' confidence in the financial market but also prevents commercial banks from adequately fulfilling their financial intermediation role adequately .Literature shows that fraud is a threat to efficient, reliable banking services and operations.

CHAPTER THREE

RESEARCH DESIGN AND METHODOLOGY

3.1 Introduction

This chapter presents the research design and methodology that were used to carry out the research. It presents the research design, the population, sample size and sampling procedure, data collection and data analysis.

3.2 Research design

The study adopted a descriptive survey design. According to Mugenda (2008), such a research design is used to obtain information concerning the current state to describe what exists in respect to variables or conditions in a situation. It enables the researcher to obtain information. It is also useful in identifying variables and hypothetical constructs and it may be used to test theories. The approach involves gathering data that describes events and then organizes, tabulates, depicts and describes data. It uses description as a tool to organize data in patterns that emerge during analysis. This method is considered appropriate because the study involves interacting with the population of interest for them to assess the determinants affecting occupational fraud in commercial banks

3.3 Target Population

Target population can be defined as a compute set of individuals, cases/objects with some common observable characteristics of a particular nature distinct from other population. According to Mugenda & Mugenda (1999), a population is a well-defined as a set of people, services, elements and events, group of things or households that are being investigated. The population of this study was all the commercial banks in Kenya. There are forty three commercial banks in Kenya and this is the group from which the sample was drawn. The respondents was drawn from employees of these banks in various levels of employment, that is, the top, middle and low level management (Mugenda & Mugenda, 1999).

3.4 Sampling and sampling procedure

Simple random sampling method was used where the researcher will sample 1 top manager, 2 middle level managers and 3 low level management staff from each institution – giving the study a sample population of 258 respondents from the target population which the researcher believes will be a good representation of the banking industry. The method spreads the sample more evenly over the population and is easier to conduct and it also gives equal chance of selection of the sample units since from the target population, a starting point is chosen, and thereafter at regular intervals (Mugenda & Mugenda 1999).

3.5 Instrumentation

The researcher developed the instruments with which to collect the necessary information. Questionnaires were used to obtain important information about the population. According to Sproul (1998), a self-administered questionnaire is the only way to elicit self-report on people's opinion, attitudes, beliefs and values. The questionnaire contained both closed-ended and also a few open ended questions. These types of questions were accompanied by a list of possible alternatives from which respondents were required to select the answer that best describes their situation.

3.6 Data collection

3.6.1 Data Collection procedure

The research was carried out using primary and secondary data. Primary data is the information the researcher obtained from the field. Primary data was collected using semi-structured questionnaires. The questionnaires was administered using drop and pick method. The questionnaires were used because they allow the respondents to give their responses in a free environment and helped the researcher gather information that would not have been given out had interviews been used. The questionnaires were self-administered to some respondents while for others the researcher administered. Secondary data refers to the information obtained from articles, books, newspapers, internet and magazines. Thus secondary data regarding occupational fraud was collected from e-resources, past published scholarly articles and other relevant materials.

3.6.2 Pilot study

Piloting was carried out to test the validity and reliability of the instruments. Validity indicates the degree to which the instrument measures the constructs under investigation (Mugenda & Mugenda, (1999). There are three types of validity test which include content, criterion and related construct validity. This study used content validity because it measured the degree to which the sample of the items represents the content that the test is designed to measure.

A pilot study was conducted by the researcher taking some questionnaires to the commercial banks which was filled by respondents. From this pilot study the researcher was able to detect questions that need editing and those that are ambiguous. The final questionnaire was then printed and used to collect data to be used for analysis.

3.7 Data analysis and presentation

The researcher used both qualitative and quantitative techniques in analyzing the data. After receiving questionnaires from the respondents, the responses was edited, classified, coded and tabulated to analyze quantitative data using Statistical Package for Social Science (SPSS) version 20.0. Tables and charts were used for presentation for easy understanding. This was coupled with the content analysis on qualitative issues to generalize the results.

The factors influencing fraud risk management approaches are β (independent variables) and dependent variable is Y.

The regression equation used was:

$$Y= \beta_0+ \beta_1X_1+\beta_2X_2+ \beta_3X_3+\alpha$$

Where Y is the dependent variable (Occupational fraud), β_0 is the regression coefficient, β_1, β_2, and β_3 and are the slopes of the regression equation, X_1 is the independent variable one (personal characteristics of bank employees), X_2 is independent variable two (closeness of customers to bank employees), X_3 is independent variable three (false financial statements) while α is an error term normally distributed about a mean of 0 and for purposes of computation, the α is assumed to be 0.

CHAPTER FOUR

DATA ANALYSIS AND INTERPRETATION

4.1 Introduction

This chapter presents analysis and findings of the study as set out in the research methodology. The studies' findings are presented to establish the determinants affecting occupational fraud in commercial banks in Kenya. The data was gathered exclusively from the questionnaire as the research instrument. The questionnaire was designed in line with the objectives of the study.

4.1.1 Response Rate

The study targeted employees of the forty three commercial banks in Kenya in collecting data with regard to establishing determinants affecting occupational fraud in commercial banks in Kenya. From the study, 250 out of the 258 sample respondents filled-in and returned the questionnaires making a response rate of 97%. This reasonable response rate was made a reality after the researcher made personal calls and visits to remind the respondent to fill-in and return the questionnaires.

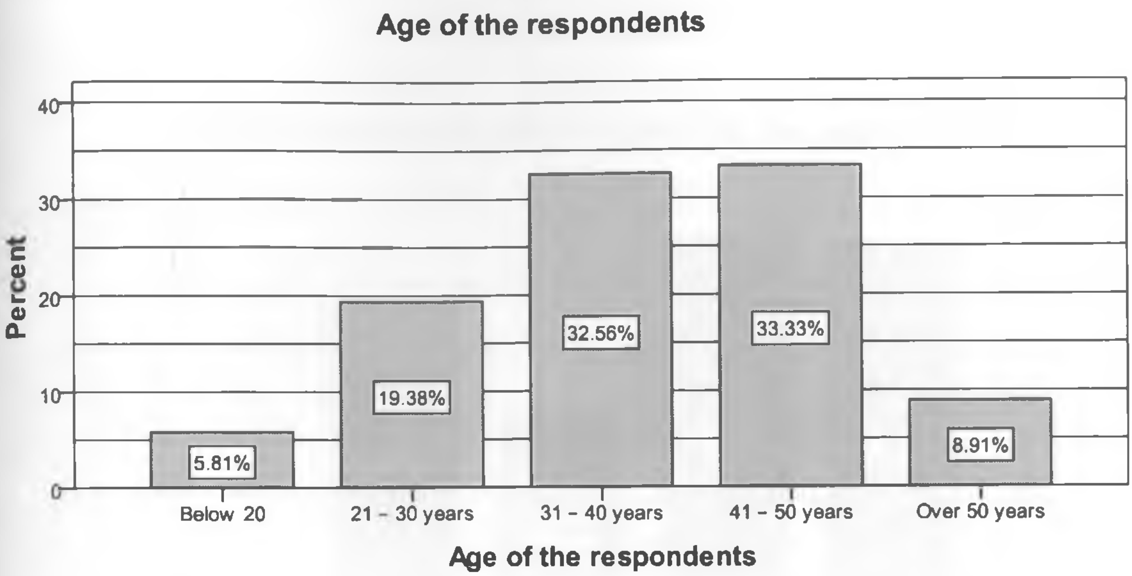

Figure 4.1: Respondents age

Respondent's age

According to the findings, 33.33% of the respondents were aged between 41-50 years, 32.56% of the respondents were aged between 31-40 years, 19.38% of the respondents were aged between 21-30 years and 8.91% of the respondents were aged over 50 years while only 5.81% of the respondents were below 20 years old.

Duration of time respondents had worked in the banking sector

The findings indicate that 5% of the respondents had worked in the banking sector for less than one year, 11.77% had worked in the banking sector for 1 – 5 years, 50% had worked in the banking sector for 5 – 10 years while the rest (33.33%) of the respondents indicated that they had worked in the banking sector for Over 10 years.

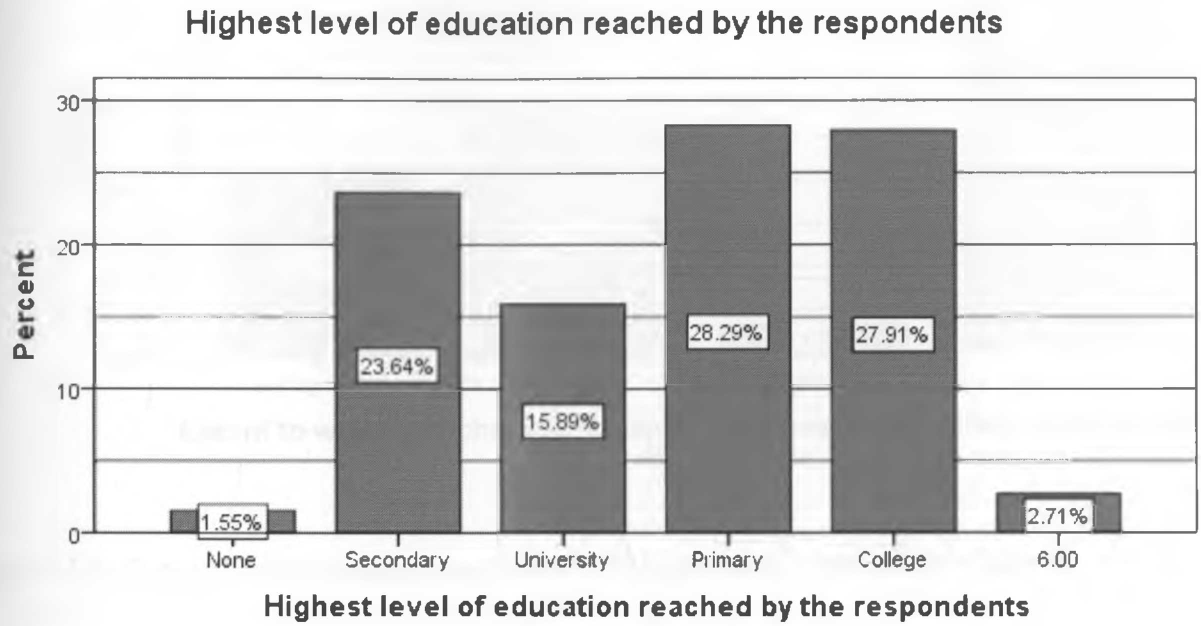

Figure 4.2: Highest level of education by the respondents.

This study found out that 28.29% of the respondents had reached primary school, 27.9% of the respondents had reached college level, 23.64% of them had reached secondary level, 15.89% of them had attended university, while 1.55% of them had not gone to school.

4.3 Characteristics of Bank Employees and Occupational Fraud

Majority of the respondents (96.90%) were of the opinion that given the right pressure, opportunities, and rationalizations, every employee is capable of committing fraud, while only 3.10% of them indicated that given the right pressure, opportunities and rationalizations, employees are not capable of committing fraud

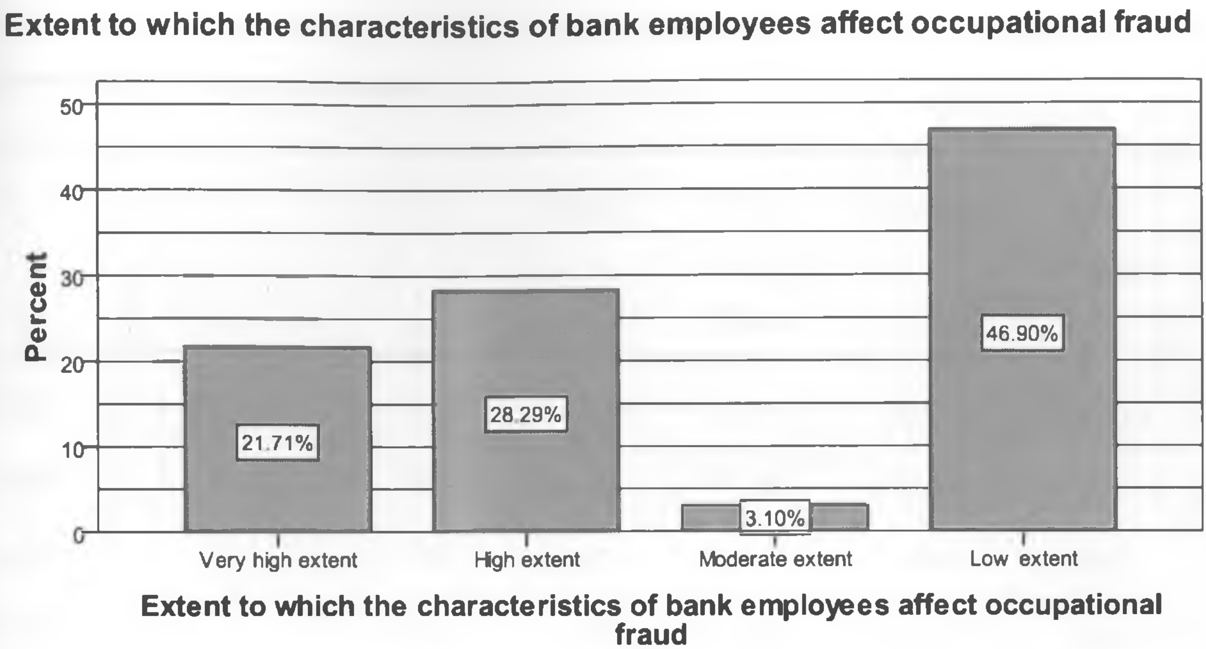

Figure 4.3: Extent to which the characteristics of bank employees affect occupational fraud

The study sought to find out the extent to which the characteristics of bank employees affect occupational fraud. According to the findings, 46.90% of the respondents indicated that characteristics of bank employees affect occupational fraud to a low extent, 28.29% of the respondents indicated that characteristics of bank employees affect occupational fraud to a high extent, 21.71% of the respondents indicated that characteristics of bank employees affect occupational fraud to a very high extent, 3.10% of the respondents indicated that characteristics of bank employees affect occupational fraud to a moderate extent.

Table 4. 1: Respondents rating on the extent that various characteristics of fraudulent employees affect occupational fraud

	N	Mean	Std. Error of Mean	Median	Std. Deviation
Intelligent	258	4.13	0.04	3.00	0.70
Egotistical	258	4.00	0.00	1.00	0.00
Inquisitive	258	3.83	0.04	4.00	0.57
Risk taker	258	3.76	0.07	1.00	1.08
Rule breaker	258	4.47	0.03	1.00	0.50
Under stress	258	4.14	0.06	3.00	0.93
Greedy	258	3.78	0.03	2.00	0.42
Disgruntled/complainer	258	2.24	0.04	2.00	0.63
Big spender	258	3.75	0.05	4.00	0.81
Having desire for gain	258	3.57	0.08	4.00	1.24
Pressured to perform	258	4.05	0.07	4.00	1.08

On the respondents rating on the extent that various characteristics of fraudulent employees affect occupational fraud, respondents indicated that rule breakers were involved in occupational fraud to a great extent as shown by a mean of 4.47; that intelligent employees were involved in occupational fraud to a great extent as shown by a mean of 4.13; that under stress, employees were involved in occupational fraud to a great extent as shown by a mean of 4.14; that employees who were pressured to perform were involved in occupational fraud to a great extent as shown by a mean of 4.05; that egotistical employees were involved in occupational fraud to a great extent as shown by a mean of 4.00; that inquisitive employees were involved in occupational fraud to a great extent as shown by a mean of 3.83; that greedy employees were involved in occupational fraud to a great extent as shown by a mean of 3.78; that risk takers were involved in occupational fraud to a great extent as shown by a mean of 3.76; that big spenders were involved in occupational fraud to a great extent as shown by a mean of 3.75; that employees with a desire for gain were involved in occupational fraud to a great extent as shown by a mean of 3.57; that disgruntled/complainers were involved in occupational fraud to a little extent as shown by a mean of 2.24

4.4 Closeness of Customers to Bank Employees and Occupational Fraud

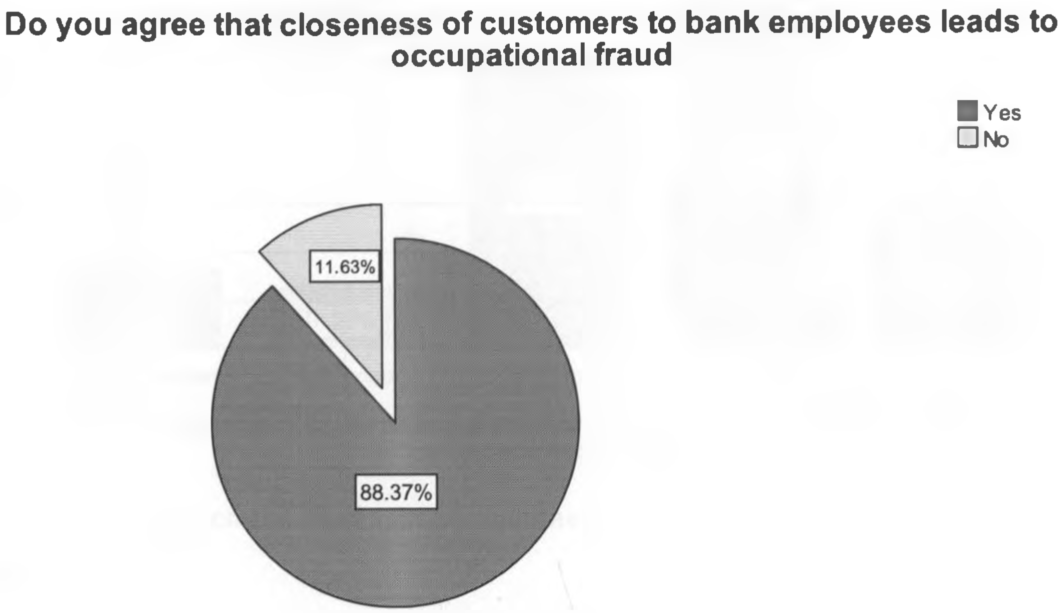

Figure 4.4: Whether closeness of customers to bank employees led to occupational fraud

The study sought to establish whether closeness of customers to bank employees led to operational fraud. According to the findings, 88.37% of the respondents indicated that closeness of customers to bank employees led to occupational fraud while 11.63% of the respondents indicated that closeness of customers to bank employees did not lead to occupational fraud.

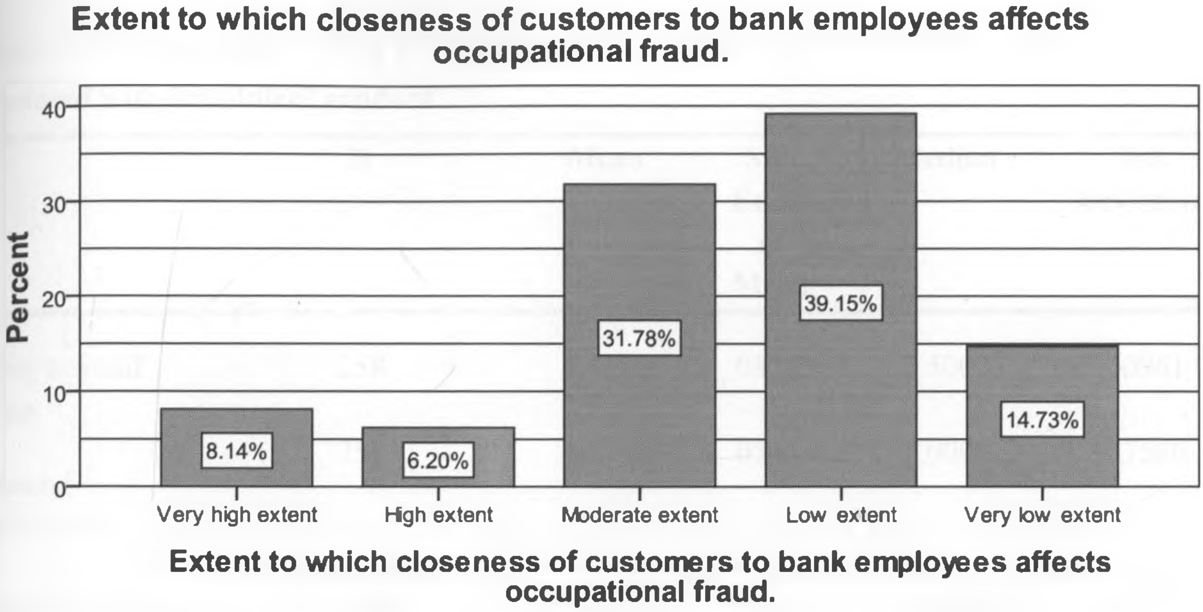

Figure 4. 5: Extent to which the closeness of customers to bank employees affects occupational fraud

Majority of the respondents (39.15%) indicated that closeness of customers to bank employees affects occupational fraud to a low extent, 31.78% of them indicated that closeness of customers to bank employees affects occupational fraud to a moderate extent, 14.73% of them indicated that closeness of customers to bank employees affects occupational fraud to a very low extent, 8.14% of them indicated that closeness of customers to bank employees affects occupational fraud to a very high extent, while the rest (6.20%) indicated that closeness of customers to bank employees affects occupational fraud to a high extent.

Table 4. 2: Respondents rating of various red flags displayed by fraudsters that are often associated with fraudulent conduct

	N	Mean	Std. Error of Mean	Median	Std. Deviation
Living beyond means	258	4.4380	.03795	2.5000	.60961
Financial difficulties	258	4.1744	.05453	2.0000	.87586
Unusually close association with customers	258	3.7411	.02957	1.0000	.47500
Excessive control issues	258	4.2442	.08487	3.0000	1.36324
Shortage of sufficient working capital	258	4.1744	.08249	3.0000	1.32493
Urgency on the part of management to have a favorable earnings record to support the company's stock-market price	258	4.1589	.05499	3.0000	.88323

Respondents were of the opinions that, to a great extent, fraudsters live beyond their means as shown by a mean of 4.4380, have excessive control issues as shown by a mean of 4.2442; had financial difficulties as shown by a mean of 4.1744; had a shortage of sufficient working capital as shown by a mean of 4.1744; argued that urgency on the part of management to have a favorable earnings record to support the company's stock-market price as shown by a mean of 4.1589 and have an unusually close association with customers as shown by a mean of 3.7411

4.5 False Financial Statements and Occupational Fraud

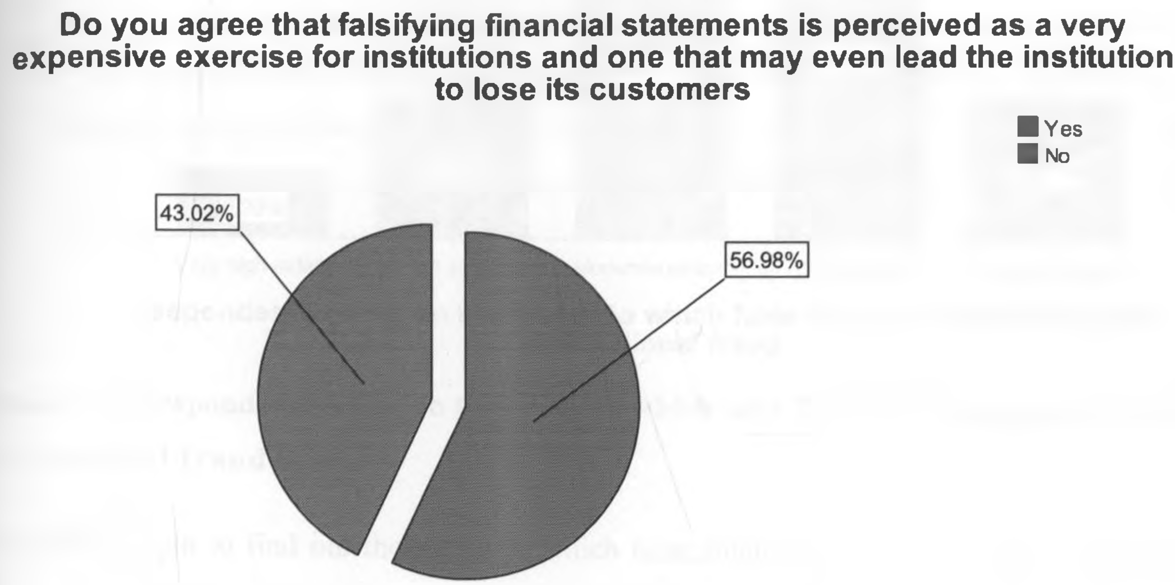

Figure 4. 6: Whether falsifying financial statements is perceived as a very expensive exercise for institutions and one that may even lead the institution to lose its customers

On whether falsifying financial statements is perceived as a very expensive exercise for institutions and one that may even lead the institution to lose its customers, 56.86% of the respondents indicated that falsifying financial statements is perceived as a very expensive exercise for institutions and one that may even lead the institution to lose its customers while 43.02% of them indicated that falsifying financial statements is not perceived as a very expensive exercise for institutions.

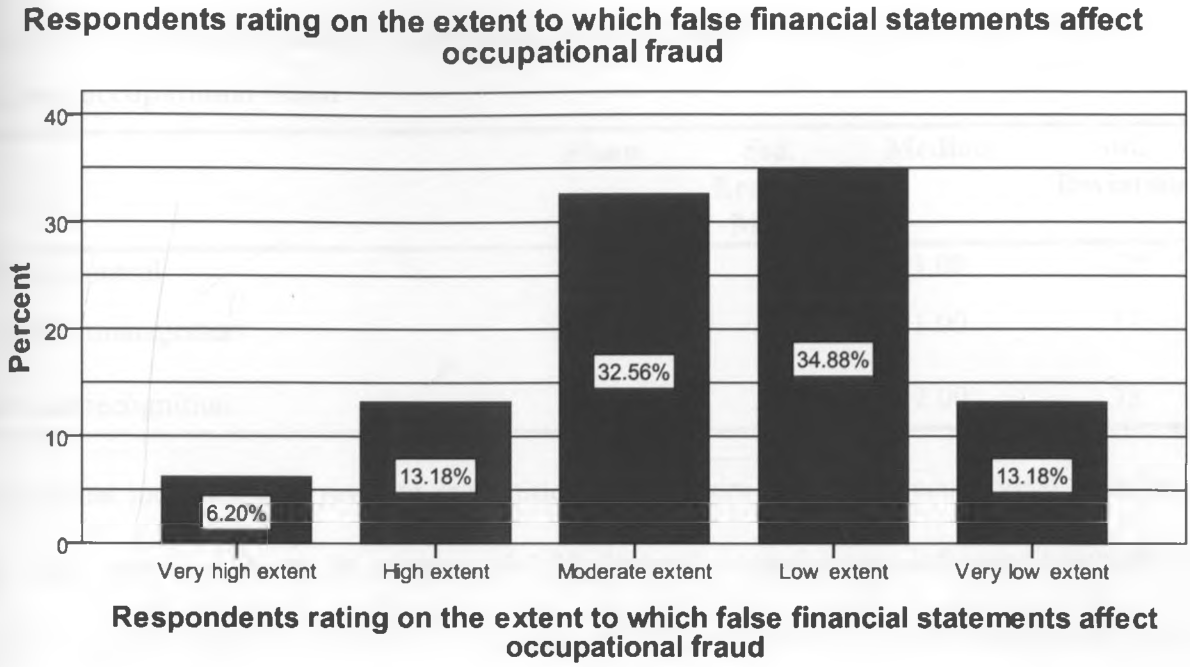

Figure 4. 7: Respondents rating on the extent to which false financial statements affect occupational fraud

The study sought to find out the extent to which false financial statements affect occupational fraud. According to the findings, 34.88% of the respondents indicate that false financial statements affect occupational fraud to a low extent, 32.56% of the respondents indicate that false financial statements affect occupational fraud to a moderate extent, 13.18% of the respondents indicate that false financial statements affect occupational fraud to a high extent, 13.18% of the respondents indicate that false financial statements affect occupational fraud to a very low extent, while 6.20% of the respondents indicate that false financial statements affect occupational fraud to a very high extent.

Table 4. 3: Respondents rating of the extent to which financial statement fraud factors influence occupational fraud

	Mean	Std. Error of Mean	Median	Std. Deviation
Internal control	4.30	.08	3.00	1.25
Earnings management	4.03	.01	1.00	.17
Revenue recognition	4.78	.05	2.00	.73

Respondents indicated that revenue recognition fraud errors influence occupational fraud to a very great extent as shown by a mean of 4.78; internal control errors influence occupational fraud to a great extent as shown by a mean of 4.30 and that earnings management errors influence occupational fraud to a great extent as shown by a mean of 4.03

4.6 Regression Analysis

Table 4. 4: Model Summary

Coefficient of determination explains the extent to which changes in the dependent variable can be explained by the change in the independent variables or the percentage of variation in the dependent variable (Occupational fraud) that is explained by all the three independent variables (Characteristics of Bank Employees, Closeness of Customers to Bank Employees and False Financial Statements.)

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	. 890a	. 793	. 783	. 36563

Source: Research, 2012

The three independent variables that were studied, explain only 79.3% of the Occupational fraud as represented by the R^2. This therefore means that other factors not studied in this research contribute 20.7% of the Occupational fraud. Therefore, further research should be conducted to investigate the other factors (20.7%) that affect Occupational fraud.

Table 4. 5: ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	46.979	4	11.745	87.853	.000[a]
	Residual	12.299	92	.134		
	Total	59.278	96			

Source: Research, 2012

The significance value is .000 which is less than 0.05 thus the model is statistically significant in predicting Characteristics of Bank Employees, Closeness of Customers to Bank Employees and False Financial Statements.) The F critical at 5% level of significance was 3.23. Since F calculated is greater than the F critical (value = 87.853), this shows that the overall model was significant.

Table 4. 6: Coefficient of determination

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	3.463	.450		7.693	0.001
	Characteristics of Bank Employees	1.091	0.159	0.897	0.107	0.004
	Closeness of Customers to Bank Employees	0.970	0.145	0.326	0.097	0.006
	False Financial Statements	0.349	0.210	0.297	0.069	0.039

Source: Research, 2012

The researcher conducted a multiple regression analysis so as to determine the relationship between Occupational fraud and the three variables. As per the SPSS generated table 4.8, the equation ($\mathbf{Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3} + \varepsilon$) becomes:

$$Y = 3.463 + 1.091X_1 + 0.970X_2 + 0.349X_3 + \varepsilon$$

Where Y is the dependent variable (Occupational fraud), X_1 is the Characteristics of Bank Employees variable, X_2 is Closeness of Customers to Bank Employees variable and X_3 is False Financial Statements.

According to the regression equation established, taking all factors into account (Characteristics of Bank Employees, Closeness of Customers to Bank Employees and False Financial

Statements.) constant at zero, Occupational fraud will be 3.463. The data findings analyzed also show that taking all other independent variables at zero, a unit increase in Characteristics of Bank Employees will lead to a 1.091 increase in Occupational fraud;, a unit increase in Closeness of Customers to Bank Employees will lead to a 0.97 increase in Occupational fraud, a unit increase in False Financial Statements will lead to a 0.349. This infers that Characteristics of Bank Employees contributes more to the Occupational fraud followed by Closeness of Customers to Bank Employees.

At 5% level of significance and 95% level of confidence, Characteristics of Bank Employees had a 0.004 level of significance, Closeness of Customers to Bank Employees showed a 0.006 level of significant, False Financial Statements had a 0.039 level of significant; hence the most significant factor is Characteristics of Bank Employees.

CHAPTER FIVE

SUMMARY OF THE FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter provides the summary of the findings from chapter four, and it also gives the conclusions and recommendations of the study based on the objectives of the study. The objective of this study was to determine factors affecting occupational fraud in commercial banks in Kenya

5.2 Summary of the Findings

5.2.1 Characteristics of Bank Employees

It was found out that given the right pressure, opportunities, and rationalizations, every employee is capable of committing fraud; that characteristics of bank employees affect occupational fraud to a low extent; that rule breakers were involved in occupational fraud to a great extent as shown by a mean of 4.47; that intelligent employees were involved in occupational fraud to a great extent as shown by a mean of 4.13; that under stress were involved in occupational fraud to a great extent as shown by a mean of 4.14; that employees who were pressured to perform were involved in occupational fraud to a great extent as shown by a mean of 4.05; that egotistical employees were involved in occupational fraud to a great extent as shown by a mean of 4.00; that inquisitive employees were involved in occupational fraud to a great extent as shown by a mean of 3.83; that greedy employees were involved in occupational fraud to a great extent as shown by a mean of 3.78; that risk takers were involved in occupational fraud to a great extent as shown by a mean of 3.76; that big spenders were involved in occupational fraud to a great extent as shown by a mean of 3.75; that employees with a desire for gain were involved in occupational fraud to a great extent as shown by a mean of 3.57; that disgruntled/complainers were involved in occupational fraud to a little extent as shown by a mean of 2.24

5.2.2 Closeness of Customers to Bank Employees

The study found out that closeness of customers to bank employees led to operational fraud; that closeness of customers to bank employees affects occupational fraud to a moderate extent; that fraudsters live beyond their means as shown by a mean of 4.4380, have excessive control issues as shown by a mean of 4.2442; had financial difficulties as shown by a mean of 4.1744; had a shortage of sufficient working capital as shown by a mean of 4.1744; argued that urgency on the part of management to have a favorable earnings record to support the company's stock-market price as shown by a mean of 4.1589 and have an unusually close association with customers as shown by a mean of 3.7411

5.2.3 False Financial Statements

The study also found out that falsifying financial statements is perceived as a very expensive exercise for institutions and one that may even lead the institution to lose its customers; that false financial statements affect occupational fraud to a low extent; that revenue recognition fraud errors influence occupational fraud to a very great extent as shown by a mean of 4.78; internal control errors influence occupational fraud to a great extent as shown by a mean of 4.30 and that earnings management errors influence occupational fraud to a great extent as shown by a mean of 4.03.

5.3 Conclusions

The study concludes that given the right pressure, opportunities, and rationalizations, every employee is capable of committing fraud; that characteristics of bank employees affect occupational fraud to a low extent; that rule breakers were involved in occupational fraud to a great extent; that intelligent employees were involved in occupational fraud to a great extent; that under stress were involved in occupational fraud to a great extent; that employees who were pressured to perform were involved in occupational fraud to a great extent; that egotistical employees were involved in occupational fraud to a great extent; that inquisitive employees were involved in occupational fraud to a great extent; that greedy employees were involved in occupational fraud to a great extent; that risk takers were involved in occupational fraud to a great extent; that big spenders were involved in occupational fraud to a great extent; that employees with a desire for gain were involved in occupational fraud to a great extent; and that disgruntled/complainers were involved in occupational fraud to a little extent.

The study also concludes that closeness of customers to bank employees led to operational fraud; that closeness of customers to bank employees affects occupational fraud to a moderate extent; that fraudsters live beyond their means, have excessive control issues; had financial difficulties; had a shortage of sufficient working capital; that urgency on the part of management to have a favorable earnings record to support the company's stock-market price and have an unusually close association with customers.

The study further concludes that falsifying financial statements is perceived as a very expensive exercise for institutions and one that may even lead the institution to lose its customers; that false financial statements affect occupational fraud to a low extent; that revenue recognition fraud errors influence occupational fraud to a very great extent; internal control errors influence occupational fraud to a great extent and that earnings management errors influence occupational fraud to a great extent.

5.5 Recommendations

The study recommends the organisations to train their employees to adopt a right attitude and work towards stress management to minimize occupational fraud. They should also have a self drive to perform, avoid overspending, and also do away with desire for gain to minimize occupational fraud. They should put in place a system to deal with staff grievances as this will to a great extent minimize occupational fraud.

The study also discourages closeness of customers to bank employees as it has been reported to lead to operational fraud to a moderate extent; employees are advised to try and live within their means, to avoid financial difficulties and hence minimizes occupational fraud.

The study further recommends that companies should avoid false financial statements as much as possible as they cause occupational fraud, avoid revenue recognition fraud errors; internal control errors and earnings management errors as they lead to occupational fraud to a great extent.

5.5 Recommendations for further studies

The study investigated the factors affecting occupational fraud in commercial banks in Kenya. To this end therefore, further study should be carried out to establish the challenges encountered in preventing occupational fraud in commercial banks in Kenya.

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Appendix I: Questionnaire

Section A: General Information

This questionnaire is meant to test the determinants affecting occupational fraud risk management in commercial banks in Kenya. Specifically it will involve aspects of bank characteristics, management, governance and technology.

1. Name of Bank (Optional) ....
2. Respondent's age (tick as appropriate)

   Below 20 [ ] 21 – 30 [ ] 31 – 40 [ ] 41 – 50 [ ]

   Over 50 [ ]

3. Department ____
4. How long have you worked in the banking sector (tick as appropriate)

   Less than 1 year [ ] 1 – 5 years [ ]

   5 – 10 years [ ] Over 10 years [ ]

5. What is your academic level of education

   Primary school [ ]

   Secondary level [ ]

   University level [ ]

6. What is your level of professional training?

   Certificate [ ] Diploma [ ]

   Degree [ ] Masters [ ]

Any other (specify) ____________________

Section A: Characteristics of Bank Employees and Occupational Fraud

7. Do you agree that given the right pressures, opportunities, and rationalizations, every employee is capable of committing fraud?

   Yes [ ] No [ ]

8. Please give reasons for your answer

____

____

____

9. Please rate the extent to which the characteristics of bank employeesaffect occupational fraud.

   Very High [ ] High [ ]Moderate [ ] Low [ ] Very low [ ]

10. Please rate the following characteristics of fraudulent employees

    Use a scale of 1 to 5 where 1 is to a very low extent and 5 is very great extent.

Rating	**1**	**2**	**3**	**4**	**5**
Intelligent					
Egotistical					
Inquisitive					
Risk taker					
Rule breaker					

Under stress					
Greedy					
Disgruntled/complainer					
Big spender					
Having desire for gain					
Pressured to perform					

Section B: Closeness of Customers to Bank Employees and Occupational Fraud

11. Do you agree that closeness of customers to bank employees leads to occupational fraud?

Yes [ ] No [ ]

12. Please give reasons for your answer

____

____

____

13. Please rate the extent to which closeness of customers to bank employeesaffect occupational fraud.

Very High [ ] High [ ] Moderate [ ] Low [ ] Very low [ ]

14. Fraudsters display one or more behavioral red flags that are often associated with fraudulent conduct. Please rate the following red flags.

Use a scale of 1 to 5 where 1 is to a very low extent and 5 is very great extent.

	1	2	3	4	5
Living beyond means					
Financial difficulties					
Unusually close association with customers					
Excessive control issues					
Shortage of sufficient working capital					
Urgency on the part of management to have a favourable earnings record to support the company's stock-market price					

Section C:False Financial Statements and Occupational Fraud

15. Do you agree that falsifying financial statements is perceived as a very expensive exercise for institutions and one that may even lead the institution to lose it scustomers?

Yes [ ] No [ ]

16. Please give reasons for your answer

____

____

17. Please rate the extent to which false financial statementsaffect occupational fraud.

Very High [ ]   High [ ] Moderate [ ]   Low [ ]   Very low [ ]

18. Please rate the following financial statement fraud factors in regard to occupational fraud Use a scale of 1 to 5 where 1 is to a very low extent and 5 is very great extent.

	1	2	3	4	5
Internal control					
Earnings management					
Revenue recognition					

Appendix II: List of Commercial Banks

ABC Bank
Bank of Africa
Bank of Baroda
Bank of India
Barclays Bank of Kenya
CFC Bank
Chase Bank
City Bank
City Finance Bank
Commercial Bank of Africa
Consolidated Bank
Co-operative Bank of Kenya
Credit Bank
Development Bank of Kenya
Diamond Trust
Dubai Bank
EABS Bank (now Ecobank)
Equatorial Commercial Bank
Equity Bank
Fidelity Commercial Bank
Fina Bank
Giro Commercial Bank
Guardian Bank
Habib A.G. Zurich
Habib Bank Ltd
HFCK
I&M
Imperial Bank
Kenya Commercial Bank
K-Rep Bank
Middle East Bank
National Bank of Kenya
NIC Bank
Oriental Commercial Bank
Paramount Universal Bank
Prime Bank
Prime Capital & Credit
Southern Credit Bank
Stanbic Bank
Standard Chartered Bank
Trans-National Bank