

Corporate Governance Regulation and Control Fraud in Nigerian  
Banks

A Thesis Submitted in Partial Fulfilment for the Requirements of  
University of Sheffield for the Degree of Doctor of Philosophy

Simisola Imelda Akintoye

School of Law

University of Sheffield

December 2015

## **Abstract**

The 2009 banking crisis in Nigeria awakened the country on the need for effective corporate governance regulation. In a bid to prevent future banking crisis in the country, this thesis examines control fraud in the 2009 banking crisis using the first five banks involved as a case study. The research addresses three major areas of concern: first, it investigates the fraudulent activities of the banks' CEOs in the periods leading to the crisis; second, it explores the involvement of other corporate actors in the banking crisis; lastly, it examines how corporate governance regulation can be improved to reduce the likelihood of future control fraud in the banking sector.

The research adopts a socio-legal method that links corporate governance regulations pre and post banking crisis to the role of corporate actors including CEO's, auditors, shareholders and Regulators in corporate governance. The research explores corporate governance as a driver of control fraud in Nigerian banks. The research suggests that prevention of control fraud is not in itself determined by provision of adequate corporate governance regulation but also include a number of enforcement mechanisms and contribution of corporate participants, a totality of which could help prevent future control frauds in Nigerian banks.

The research contributes to theory, practice and policy. First, it integrates and enhances appropriate literature and knowledge on corporate governance regulation in Nigerian banks. Also, by using the concept of control fraud to understand the banking crisis of 2009; the research unfolds a relatively new type of fraud perpetrated by CEOs in collaboration with other corporate individuals. This is the first study of its kind in Nigeria and will be useful for future studies to adopt in conducting similar research.

The research also influences regulators and policy makers by providing a set of recommendations for each actor in corporate governance which can be incorporated into law in the fight against future control frauds in Nigerian banks.

## **Dedication**

To Mum and Dad

Without you this would not have been possible

## **Acknowledgements**

My Sincere gratitude and special thanks goes to:

- My Supervisor Prof. Andrew Johnston for his endless support, diligence and prompt feedbacks on all my ideas and drafts.
- My Second Supervisor Dr. Jay Cullen for his contribution and feedbacks to my research.
- My Family: Mum and Dad, Motunrayo, Foluso, Abimbolu and Segun Iyaniwura.
- My Husband, Babatunde, for been very supportive in the course of this thesis.
- My Son, Enoch, for the joy you have brought to our family.
- Above all I am grateful to God for the grace and strength to successfully complete this thesis.

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## **Abbreviations**

AGM Annual General Meeting

AMCON Asset Management Corporation of Nigeria

ANAN Association of National Accountants of Nigeria

APC Administrative Proceedings Committee

AWD Akintola Williams Deloitte

BAC Banks Audit Committee

BCCI Bank of Credit and Commerce International

BOFIA Banks and Other Financial Institutions Act

BOFID Banks and Other Financial Institutions Decree

BTN Baker Tilly Nigeria

CAC Corporate Affairs Commission

CAMA Companies and Allied Matters Act

CBN Central Bank of Nigeria

CCO Chief Compliance Officer

CDC Commonwealth Development Corporation

CEOs Chief Executive Officers

CM Class Meeting

CPI Corruption Perceptions Index

DHs Discount Houses

DMBs Deposit Money Banks

DW Discount Window

ECB European Central Bank

EDW Expanded Discount Window

EFCC Economic and Financial Crimes Commission

EGM Extraordinary General Meeting

FRC Financial Reporting Council

FRSCC Financial Services Regulation Coordinating Committee

ICAN Institute of Chartered Accountants of Nigeria

IFAC International Federation of Accountants Committee

ISA Investments and Securities Act

LAPFF Local Authorities Pension Fund Forum

LOLR Lender of Last Resort

MAS Management Advisory Services

MD Managing Directors

MFBs Micro Finance Banks

NDIC Nigerian Deposit Insurance Corporation

NEPD Nigerian Enterprises Promotion Decree

NSA National Standards on Auditing

NSE Nigerian Stock Exchange

OECD Organization for Economic Corporation and Development

OFR Officer of the Order of the Federal Republic of Nigeria

PMIs Primary Mortgage Institutions

PwC PricewaterhouseCoopers

SAP Structural Adjustment Programme

SAS Statement of Auditing Standards

SEC Securities and Exchange Commission

SFO Serious Fraud Office

UBA United Bank for Africa

USA United States of America

## **List of Statutes**

Banks and Other Financial Institutions Act (BOFIA) CAP B3, Laws of Nigeria, 1991 (Now 2004)

Companies and Allied Matters Act Chapter 59 Laws of the Federal Republic of Nigeria, 1990 (Now 2004)

Central Bank of Nigeria Act, 2007

Freedom of Information Act, 2011

Financial Reporting Act, 2011

Institute of Chartered Accountants of Nigeria Act No 15 of 1965

Investment and Securities Act, 2007

Sarbanes Oxley Act, 2002

## **Codes**

Code of Corporate Governance for Banks and Discount Houses in Nigeria and Guidelines for Whistle Blowing in the Nigerian Banking Industry, 2014

CBN Prudential Guidelines for Deposit Money Banks, 2010

CBN Guidelines on the Expanded Discount Window Operations, October 2008.

Code of Corporate Governance for Banks in Nigeria Post-Consolidation, 2006

Code of Corporate Governance for Banks and Other Financial Institutions in Nigeria, 2003

Code of Corporate Governance for Public Companies in Nigeria, 2011

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[http://ndic.org.ng/files/NDIC\\_1999\\_ANNUAL\\_REPORT.pdf](http://ndic.org.ng/files/NDIC_1999_ANNUAL_REPORT.pdf) accessed 02 June 2012

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Corporate Governance Code of Listed Companies, France, 2008

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*Access bank V. Akingbola & Ors* [2012] EWHC 2148(Comm).

*AGC Advances Ltd V. R. Lower Lippman Figdot and Frank* (1991) ASCSR 337

*Automatic Self-cleansing Filter Syndicate Co. v. Cunninghame* (1906) 2 Ch. 34  
*Coleman v Myers* (1977) 2 NZLR 225

*Danson Izedomwen & Ors v Union Bank Plc & Ors* Suit No. FHC/B/290/2009.

*Mr. Boniface Okezie v The Central Bank of Nigeria* Suit No. FHC/L/CS/494/2012

*Okey Nwosu, Dayo Famoroti, Agnes Ebubedike and Danjuma Ocholi V. Federal Republic of Nigeria* Charge No: ID/115C/2011

*Peskin v Anderson* [2001] 1 BCLC 372, [2001] BCC 874

*Re Thomas Gerard and Sons Limited* (1986) CH. 455

*Ndoma V Chukwuogor* [2004] All FWLR [Pt 217] 735

*NDIC V. Oken Enterprises Ltd* (2004) 4SC [PT 11] 77

*Wells V. Zenz*, 1927 (83) Cal App.137 (236) 485

# Chapter 1

## Introduction

### 1.1 Background to the Study

The topic of corporate governance regulation, particularly following periods of financial crisis, has been at the epicentre of debates for scholars across various institutions ranging from law to politics, economics and regulatory bodies.<sup>1</sup> The fall of multi-national companies like Enron and Bank of Credit and Commerce International (BCCI) due to control fraud have increased global concerns on the need for regulation of corporate governance.<sup>2</sup> Following the global financial crisis, many public organisations have resorted to improving corporate governance standards in a bid to reduce fraud.<sup>3</sup>

In Nigeria, fraud is endemic. The past few decades have witnessed significant financial reforms in the Nigerian banking industry in a bid to promote greater integrity in the sector. As will be shown in the thesis, fraud in the Nigerian banking sector has reached epidemic proportions contributing to the country's economic depression.<sup>4</sup>

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<sup>1</sup> Mehran, H., Morrison, A., Shapiro, J. (2011) 'Corporate Governance and Banks: What have we learned from the Financial Crisis?' 502 *Federal Reserve Bank of New York Staff Reports* 3

[http://www.newyorkfed.org/research/staff\\_reports/sr502.pdf](http://www.newyorkfed.org/research/staff_reports/sr502.pdf) accessed 12.12.14

<sup>2</sup> For instance, Enron was America's seventh largest firm in market capitalizations by August 2002, with its stock price at \$90. However, by the time Enron fell, its stock has decreased to around 40 cents a share, making it the world's biggest financial fraud and largest audit failure. (Bratton, W., W., (2002) 'Enron and the dark side of shareholder value' 76 *Tulane. Law Review* 1275.1335)

<sup>3</sup> Ibid

<sup>4</sup> Bolton R.J., Hand D.J., (2002) 'Statistical Fraud Detection: A Review' 17 *Journal of Statistical Science* 235-249

In a speech on consolidation and strengthening of banks, the former Central Bank of Nigeria (CBN) governor, Charles Chukwuma Soludo<sup>5</sup> identified six major problems faced by Nigerian banks, which justified the need for consolidation. These were:

1. Weak corporate governance particularly demonstrated by inaccurate reporting, non-compliance with regulatory requirements;
2. Late or non-publication of financial accounts;
3. Insider abuse leading to a high level of non-performing loans;
4. Insolvency through negative capital adequacy ratios and eroding shareholders' funds by operating losses;
5. Weak capital base; and
6. Over-dependency on deposits from the public.<sup>6</sup>

According to him:

‘The Nigerian banking system faces enormous challenges which, if not addressed urgently could snowball into a crisis in the near future. We don’t have to wait for the crisis to explode before we act. The Nigerian banking system today is fragile and marginal. Our vision is a banking system that is part of the global change, and which is strong, competitive and reliable. It is a banking system which depositors can trust, and investors can rely upon. Evolving such a banking system is a collective

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<sup>5</sup> The number of banks subsequently reduced to 24 following the merger of two. (Heynes, S. (2010) ‘Fighting Fraud in Nigeria- What Progress has been made’ 29 *KPMG Forensic Fighting Fraud*, 16-17)

<sup>5</sup> Charles Chukwuma Soludo was the CBN Governor from 2004-2009  
<http://www.cenbank.org/museum/Governors.htm> Last accessed 21.10.14

<sup>6</sup> Charles Chukwuma Soludo, ‘Consolidating the Nigerian banking industry to meet the development challenges of the 21st century’ (Special Meeting of the Bankers’ Committee, Abuja, 6 July 2004) P. 3

<http://www.bis.org/review/r040727g.pdf> accessed 20.12.14

responsibility of all agents in the Nigerian economy.  
Everyone has a role to play.’<sup>7</sup>

The above statement appears to have anticipated the crisis of 2009. What then followed was the introduction of a recapitalization scheme by the CBN in 2005 with a new minimum share capital requirement of N25Billion (\$167million)<sup>8</sup>, which encouraged larger banks to acquire smaller ones in order to meet the requirement. The recapitalization exercise therefore saw the consolidation of 89 banks into 25.<sup>9</sup> It was believed that the CBN launched this scheme with the intention of making Nigeria part of the ‘big league’ as one of the 20 biggest economies in the world by 2020.<sup>10</sup>

However, while it can be said that the CBN governor was right to enumerate the ongoing problems and challenges faced by Nigerian banks at the time, the consolidation exercise was insufficient to prevent the crisis. What was needed was not only an identification of the problems, but an examination of the underlying cause of the problems faced by the banks as well as solutions to solve them. It was therefore not surprising that on the 14<sup>th</sup> of August 2009, the CBN governor at the time, Sanusi Lamido Sanusi, upon investigation of five of the existing banks in the country revealed that most banks in operation were experiencing financial distress due to fraudulent practices and mismanagement of funds.<sup>11</sup> Five major banks were revealed to be in grave distress. These were Oceanic Bank Plc, Intercontinental Bank Plc, Afribank, Finbank and Union Bank. As a result, the CEOs and Board of

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<sup>7</sup> Ibid

<sup>8</sup> The minimum capital requirement prior to this was N1.0 billion (\$7.53 million at the time) for existing banks and N2.0 billion (\$15.06million) for new banks.

<sup>9</sup> The number of banks subsequently reduced to 24 following the merger of two. (Heynes, S. (2010) ‘Fighting Fraud in Nigeria- What Progress has been made’ 29 *KPMG Forensic Fighting Fraud*, 16-17)

<sup>10</sup> Otusanya, O. J., Lauwo, S., and Ajibolade, S. O. (2013) ‘An investigation of corporate executive fraud by CEOs in the Nigerian banking sector’ 2(1) *African Journal of Accounting, Auditing and Finance*, 65, 69 (Quoting *Tell Magazine*, 31<sup>st</sup> August 2009)

<sup>11</sup> Sanusi Lamido Sanusi ‘Address by the Governor of the Central Bank of Nigeria, Mallam Sanusi Lamido Sanusi on Developments on the Banking Sector in Nigeria (Abuja 14 August 2009)

<http://www.cenbank.org/Out/speeches/2009/Govadd-14-8-09.pdf> accessed 12.10.14

Directors of the five banks were fired and replaced<sup>12</sup> in accordance with Sections 33 and 35 of BOFIA 1991.<sup>13</sup>

Eight interrelated factors were considered to be responsible for the crisis. These included macroeconomic instability evidenced by sudden and large capital inflows, lack of investor confidence, significant failure in banks' corporate governance, inadequate transparency and disclosure, uneven supervision and enforcement, gaps in regulations and regulatory framework, un-coordinated management and governance process at the CBN and weak business environment.<sup>14</sup>

It can be said that most of the problems identified in 2004 have reoccurred. It can be suggested that the consolidation exercise added to the problem rather than solving it. This is because due to the pressure by banks to meet up with the new financial requirements and also the need to reflect global trends of corporate governance. The extent of fraudulent activities within the banks cannot be over-emphasized and how the gaps in regulation as identified by the CBN were used to perpetrate fraud. Failure of the regulatory framework, that is, Company Law and Corporate Governance Codes to prevent the crisis becomes a major concern.

The CBN governor further acknowledged that the Central Bank as a whole lacked a well-structured management procedure which allowed fraud to eat deep into the system for a long time, particularly from the consolidation period to the point of the crisis. (The period from 2005-2009). This no doubt created more room for a web of financial frauds involving various

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<sup>12</sup> Ibid 3.

<sup>13</sup> Now 2004. The combined effect of the Section provides the CBN the right to intervene in any bank in distress.

<sup>14</sup> Sanusi Lamido Sanusi 'The Nigerian Banking Industry: What went wrong and the way forward (Convocation Lecture, Bayero University, Kano, 26 February 2010) 5-11. [http://www.cenbank.org/OUT/SPEECHES/2010/THE%20NIGERIAN%20BANKING%20INDUSTRY%20WHAT%20WENT%20WRONG%20AND%20THE%20WAY%20FORWARD\\_FINAL\\_260210.PDF](http://www.cenbank.org/OUT/SPEECHES/2010/THE%20NIGERIAN%20BANKING%20INDUSTRY%20WHAT%20WENT%20WRONG%20AND%20THE%20WAY%20FORWARD_FINAL_260210.PDF) accessed 22.10.14

categories of people who used weak corporate governance regulation as a means to perpetrate fraud.

This type of fraud, involving top officials, that is, the CEOs of the banks, as well as other accomplices, becomes a carefully organised corporate crime, the type identified by William Black as ‘Control Fraud’ where apparently legitimate organisations, (in this case, banks) are controlled by financial super-predators (The CEOs) who use them as a means to perpetrate fraud.<sup>15</sup> The inadequacy of corporate governance practices evidenced by weak regulation, lack of transparency and disclosure created the opportunity for control fraud to occur. It follows that bad corporate governance creates potential for control fraud as there is a link between corporate governance and control fraud.

## **1.2 Study Aims and Objectives**

In view of the above, the aim of this research is to investigate the banking crisis of 2009 using the above named five banks as a case study. The study aims to explore why corporate governance regulations failed to prevent the control fraud and to suggest ways of improving the regulatory framework in order to prevent or at least reduce future control fraud in Nigerian banks.

The objective of the thesis is to investigate how legal and regulatory framework in place was bypassed to the detriment of depositors, creditors, shareholders and the general public.

Nigeria’s corporate governance regime is made up of a combination of Laws and Codes. The Companies and Allied Matters Act (CAMA), 1990,

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<sup>15</sup> Black, W. K.. (2005) *The Best Way to Rob a Bank is to Own One*. Texas: University of Texas Press William Black was the first person to introduce Control Fraud as a type of fraud perpetrated by people who use their control of the company itself as a vehicle for fraud.

governs all companies in Nigeria<sup>16</sup> while the Banks and Other Financial Institutions Act (BOFIA), 1991, is targeted to all banks in the country.<sup>17</sup> However, two major regulators in the banking industry have developed Codes of corporate governance for banks.<sup>18</sup> These are the Central Bank of Nigeria (CBN) and the Securities and Exchange Commission (SEC). The Codes amongst others are intended to regulate corporate activities within the sector.

The research suggests that the differences between countries will mean that corporate governance regulation in any economy should be culture specific and in the case of Nigeria, this would mean a number of things, including the need to eradicate or reduce corruption, improve enforcement mechanisms and encourage more participation from key stakeholders. The study aims to look into the fundamental problems in the Nigerian system of codes; one of which is the issue of regulatory multiplicity. The conflicts that exist between the codes would suggest a lacuna that could allow loopholes for the perpetration of fraud. This problem is linked to the fact that the codes were copied from developed countries and did not reflect the specific configurations of Nigeria.<sup>19</sup>

The research further suggests the need for a combined code of corporate governance in Nigeria that takes into consideration the peculiarities of the country and addresses the institutional challenges faced in the system. It is important that corporate governance principles are specifically designed to

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<sup>16</sup> CAMA, 1990 (Now 2004)

<sup>17</sup> BOFIA, 1991 (Now 2004)

<sup>18</sup> Code of Corporate Governance for Banks in Nigeria Post Consolidation, 2014; Code of Corporate Governance for Public Companies, 2011

<sup>19</sup> For instance, the CBN Code was copied from the US while the SEC Code was copied from the UK. Osemeke, L. And Adegbite, E. 2014, 'Regulatory Multiplicity and Conflict: Towards a Combined Code of Corporate Governance in Nigeria.' *Journal of Business and Ethics* 8 (referring to one of their focus group respondents)



meet the needs of a particular jurisdiction as opposed to transplanting western norms.<sup>20</sup>

The thesis therefore reaches the conclusion that Nigeria's corporate governance is in dire need of reform to address issues that are endemic in the society. Corruption is probably impossible to eradicate but can be significantly reduced if there is operational unity involving teamwork by all participants within the corporate governance system.

### 1.3 Why Nigeria?

This thesis is limited to corporate governance regulation and control fraud in Nigerian banks. The choice of Nigeria emanates from the country's position in Africa's economy which also impacts across the world.

As the most populated country in Africa with over 183million people and the 7<sup>th</sup> most populated country in the world,<sup>21</sup> the Nigerian economy is largely based on oil production which accounts for about 80% of its Gross Domestic Product and more than 90% of its exports.<sup>22</sup> The Nigerian Stock Exchange,<sup>23</sup> the second largest capital market in Africa<sup>24</sup> is made up of 260 public limited companies and total market capitalization of \$125 billion.<sup>25</sup> The largest Plc, Dangote Group of Companies ranks 1434<sup>th</sup> position in the

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<sup>20</sup> Adegbite, E (2012) 'Corporate Governance Regulation in Nigeria' 112(2) *Corporate Governance: The International Journal of Business in Society* 257-76

<sup>21</sup> Source: <http://www.worldometers.info/world-population/nigeria-population/> Last accessed 13.08.15

<sup>22</sup> With the second being Agriculture. Source: <http://www.Mbendi.com.energysector.html> Last accessed 06.08.14

<sup>23</sup> Source: [http://www.nigeriainvestment.com/doing\\_business/nigeriastockexchange.html](http://www.nigeriainvestment.com/doing_business/nigeriastockexchange.html) Last assessed 27.08.14

<sup>24</sup> The first being the Johannesburg Stock Exchange (JSE): <http://www.advfn.com/StockExchanges/about/JSE/JohannesburgStockExchange.html> Last assessed 27.08.14

<sup>25</sup> Figures as at the end of 2007. Source: The Nigerian Stock Exchange available at: [http://www.nigerianstockexchange.com/quoted\\_companies.jsp](http://www.nigerianstockexchange.com/quoted_companies.jsp) Last Accessed 06-08-2011

list of the world's biggest public companies<sup>26</sup> with an asset value of \$2.1 Billion and a market value of \$12.5 Billion; Nigeria is therefore an important player in the global corporate economy.

Nigeria is however, confronted with a significant problem of corruption and fraud. The Annual Comparative list of worldwide corruption known as Corruption Perceptions Index (CPI) published by Transparency International<sup>27</sup> in 2010 reveals that on a scale of 0 (highly corrupt) to 10 (very clear); Nigeria's level of corruption is 2.4. Nigeria currently ranks 136 out of the 175 countries listed on the index.<sup>28</sup> This level of corruption threatens the credibility of the country as a place for inward investment and development.

Furthermore, this thesis focuses on the banking sector as a very important player in Nigeria's corporate world. In 2009, the banking sector was faced with a financial crisis, the worst of its kind in the history of Nigerian banks. Whilst taking the peculiarities of Nigeria's institutional structure into account, the thesis investigates the activities of the five banks which, upon investigation by the CBN were declared to be in grave financial distress in 2009.<sup>29</sup> Evidence is limited as to the activities of these banks in the periods preceding the crisis. The reason for this is not far-fetched. First, the CBN revealed that the level of non-performing loans granted by these five banks amounted to 39.9 percent of the total loans in the banking sector.<sup>30</sup>

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Source: [http://www.forbes.com/global2000/#p\\_144\\_s\\_acompanyRankOverall\\_All\\_All\\_All](http://www.forbes.com/global2000/#p_144_s_acompanyRankOverall_All_All_All) Last accessed 06.08.2014

<sup>27</sup> A non-governmental organisation monitoring corporate and political corruption worldwide through the publication of annual corruption perceptions index. Source: <http://www.transparency.org> last accessed 20.08.14

<sup>28</sup> 2014 results. Available at <http://www.transparency.org/cpi2014/results> Last accessed 20.08.15

<sup>29</sup> These are Oceanic Bank Plc, Intercontinental Bank, Union Bank Plc, Finbank Plc and Afriland Plc.

<sup>30</sup> Otusanya *et al* (n 10) 70.

Furthermore, being the first five banks to be investigated, it is interesting to unravel the series of events following the indictment of the CEOs as they became subject of public interest due to the grave amount of financial misappropriation involved. It is also interesting to examine how the CEOs connived with other corporate participants, using both regulatory weakness and political affiliation to create a friendly environment for the perpetration of control fraud. The wave of activities of the perpetrators becomes interesting to examine as a case study in order to understand the link between corporate governance regulation and control fraud.

Also, the periods after the crisis unravelled series of investigations by various bodies such as the Economic and Financial Crimes Commission (EFCC) as well as the Securities and Exchange Commission (SEC). Other bodies in the web of corporate governance were also appalled as to how the crisis came to be. Shareholders and depositors demanded answers to know who was to blame for the crisis which led to the near collapse of the Nigerian Stock exchange at the time.<sup>31</sup>

#### **1.4 Originality**

The research will be a major contribution to the on-going global literature on corporate governance; it will also contribute to the limited literature for developing countries, particularly Nigeria, and will greatly expand the knowledge and understanding of how important appropriate regulation is to effective corporate governance.

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<sup>31</sup> The banking sector is one of the areas that was hit by the crisis in Nigeria; another major sector was the oil and gas sector which is outside the scope of this thesis, however, the crisis as a whole saw the near collapse of the Nigerian Stock Exchange, which led to concerns regarding the corporate governance regime of the country. Report of the Ad-Hoc Committee on Capital Market on the near collapse of the Nigerian Stock Exchange. <http://proshareng.com/news/download.php?item=AdHocCommitteeonCapMktReport19%20200712.pdf> accessed 17.12.14

The research aims to examine corporate governance regulation through the lens of control fraud, the first study of its kind in Nigeria. The thesis is the first study to use the lens of control fraud to explore the Nigerian banking crisis by providing an exposition of the activities of major participants in the fraud. The problem of control fraud is investigated as a peculiar challenge of Nigerian banks and will therefore make original contribution in terms of diagnosing the problem and suggesting ways to improve corporate governance regulation in Nigeria.

The research will also hopefully influence policy and decision-makers. It emphasizes the need to reform Nigeria's corporate governance regime and makes a number of recommendations. By identifying the complex causes of the 2009 banking crisis, the thesis intends to help reduce the chance of future control frauds in Nigerian banks.

### **1.5 Research Questions**

This thesis is an investigation into control fraud in Nigerian banks using the 2009 banking crisis as a case study.

In this context, the thesis seeks to answer the following key questions in Nigerian banks:

1. Why did the corporate governance system in place in Nigerian banks fail to prevent control fraud?
2. How has Nigeria's institutional problem contributed to the perpetration of control fraud during the crisis?
3. How did the activities of corporate participants in the periods leading to the crisis contribute or facilitate the fraud?
4. What changes to corporate governance norms, codes and regulation are required to prevent future control fraud in Nigerian banks?

The next section will attempt to present the issues to be examined in the thesis and provide a brief outline of the structure of the thesis.

## **1.6 Structure**

Chapter 2 Literature Review: This chapter will examine the literature on corporate governance and control fraud. It will commence with an examination of the concept of corporate governance. This will be followed by a broad definition of fraud, with particular reference to Nigeria. The most prominent type of fraud in the Nigerian criminal code will be also be analysed, that is Section 419. The chapter will then discuss corporate governance in the Nigerian banking system. This will be followed by a discussion of notable cases of control fraud in order to establish the link between control fraud and corporate governance. The aim of the chapter is to identify gaps in literature that will further emphasize the significance of the research.

Chapter 3 Methodology: this chapter will briefly discuss the methodology to be adopted in the research, that is, the socio-legal methodology and the reasons for adopting this method. There will be a brief summary of the theoretical underpinnings of the research including the agency theory and deterrence theory. Sources and data used will be also be identified. The chapter will then discuss the limitations of the research and the problems the researcher encountered in the process of data collection will be highlighted.

Chapter 4: Control fraud of CEOs in the Nigerian banking sector: this chapter will look at the involvements of the CEOs of the five banks in the collapse of their banks. The chapter will begin with a background to the crisis, that is, the consolidation exercise of 2006. This is to create awareness of how the new financial obligation of banks as directed by the CBN at the time might have triggered control fraud in a bid to meet with the on-going demands of the CBN at the time. The chapter will then explore the activities

of the each of the CEOs and show how these amounted to control fraud. The chapter will also examine how the CEOs of the banks took advantage of regulatory weaknesses in the perpetration of fraud. It will emphasize that although CEOs are the main agents in control frauds, they need the collaboration of other participants such as auditors, shareholders and regulators. Issues such as the regulatory weakness of the CBN which paved way for the persistent use of the discount window will be introduced.

Chapter 5: The Role of the Regulatory Framework in the perpetration of control fraud: This chapter will link corporate governance regulation in Nigeria to control fraud. There will be an examination of the institutional framework; that is, regulation and policy. Various codes that have evolved in Nigeria's corporate governance pre and pro crisis will be examined. Problems such as regulatory multiplicity and rules/principles based nature of enforcement of the existing codes will be analysed. Emphasis will be placed on the fact that Nigeria copied its corporate governance codes from developed countries, particularly UK and USA with no consideration for the peculiarity of jurisdictions and this has facilitated control fraud. The chapter stresses that weak regulation and enforcement are major factors responsible for control fraud in Nigerian banks,

Chapter 6: The regulatory involvement of the Central Bank of Nigeria (CBN) in the Banking crisis. This chapter examines the regulatory and supervisory function of the CBN as a whole and focuses on the activities of the CBN during the banking crisis, particularly; internal regulatory weaknesses that could suggest lack of capacity to deal with control fraud. The politics played by the CBN will also be analysed by reference to literature and available evidence, particularly in its refusal to publish the results of the special investigation that led to the removal of the five CEOs. The roles played by regulators such as president, senate and courts will also be discussed.

Chapter 7: An assessment of the role of Auditors in the banking crisis: This chapter will explore the activities of the auditors of the five banks in question in order to examine whether or not they were complicit in the control fraud of 2009. The chapter will commence by explaining the expectations gap of auditing and the notion of audit explosion will be analysed in detail. The issue of auditor independence, particularly on the provision of non-audit fees by the auditors in question will be explored in order to emphasise the possible connivance or passivity of the auditors with CEOs of the banks. Although both internal and external auditors can be said to have allowed control fraud to happen, the fact that none of the said auditors have been brought to book since the crisis suggests a fundamental problem of regulation, particularly the effect of bad corporate governance regulation on control fraud.

Chapter 8: Investigation of the role of Shareholders in control fraud: Evidence from the banking crisis: This chapter will look at the involvement of shareholders in the control fraud of 2009. Particular attention will be drawn to majority shareholders of these banks and political domination utilised in the perpetration of fraud through connivance of the CEOs, politicians and majority shareholders in order to explore the mechanics of control fraud in the banks in question. Issues such as rent seeking through governmental involvement will also be discussed. Shareholder primacy will then be discussed and its possible contribution to control fraud examined.

Chapter 9: Corporate Governance and Control Fraud in Nigerian Banks; The Way Forward: This chapter will recap the issues identified throughout the research in order to make recommendations. There will be suggestions on the way forward for Nigerian banks in the fight against future control fraud. Participation of all corporate participants such as CEOs, auditors, shareholders and regulators will also be emphasized with recommendations

on how this can be achieved. Lastly, the chapter will discuss contributions of the research to theory, practice and policy.



## Chapter 2

### Literature Review

#### 2.1 Introduction

The problem of fraud remains a universal phenomenon of which the magnitude cannot be known for certain because most frauds are undetected, and not all detected frauds are published.<sup>32</sup> With the fall of multi-national companies like Enron, and high level of allegations and actual cases of control fraud<sup>33</sup> across the globe, the need to promote corporate governance becomes more important. Many organisations have therefore resorted to developing ethical guidelines and codes of conduct aimed at ensuring compliance to minimum standards of corporate ethics targeted at controlling fraud.<sup>34</sup>

The financial sector is the epicentre of most economies and activities are mainly based on trust and confidence. It is good practice that potential investors satisfy themselves of the existence of strong business environment before any financial commitment; they, therefore, assess political, business and financial risks involved. Countries with poor business environment lose attraction in trade and investment, having failed to establish standards of transparency, fairness and accountability which are the themes of efficient corporate governance.<sup>35</sup>

In Nigeria, the growth and rate of the occurrence of fraud in recent years is appalling in virtually all spheres of the economy especially in the banking

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<sup>32</sup> Ajayi, M.A. (2011) 'Determinants of Fraud in the Nigerian Banking Industry' 3(2) *Lapai Sociological Law Review* 101

<sup>33</sup> This will be defined below.

<sup>34</sup> Bratton, W., W., (2002) 'Enron and the dark side of shareholder value' 76 *Tulane. Law Review* 1275

<sup>35</sup> Okeahalam C., C., Akinboade O., A. (2003) 'A review of Corporate Governance in Africa: Literature, Issues and Challenges' *A paper presented for the Global Corporate Governance* (15 June, 2003) 8-11

sector. The gravity of control fraud in Nigerian banks can be inferred from its value, volume and loss. The Nigerian Deposit Insurance Corporation<sup>36</sup> (NDIC) reported that the level of actual fraud in Nigerian banks rose from N804million in 1990 to N3,199 million in 1998, leaving the percentage of amount loss to fraud rising from 3% in 1990 to 22% in 1998.<sup>37</sup> However, the year 2009 saw the highest level of banking fraud, where a total of 1, 764 cases of attempted fraud involving over N41.3billion was reported, out of which ten banks with the highest number of cases were responsible for 90.10% (N37billion).<sup>38</sup> It can therefore, follows that fraud is perhaps the most challenging of all the risks confronted by the Nigerian banking sector and it can be said to be an institutional problem of corruption.

In view of this, it is the focus of this chapter to review the literature on control fraud and corporate governance. It will commence with an examination of the concept of corporate governance and will delve into corporate governance in banks in order to establish the peculiarity of banks as having a unique form of governance different from other companies. Corporate governance in Nigerian bans will then be examined and linked to fraud and control fraud. Some cases of control fraud across the globe will be cited in order to establish the relationship between corporate governance and control fraud. The chapter stresses that the peculiarities of systems across the world will mean that corporate governance in Nigeria should be culture-specific and in the case of Nigerian banks, corporate governance ought to be understood slightly differently and a unique set of corporate governance norms is required to help curb control fraud.

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<sup>36</sup> The NDIC is an independent agency set up by the federal government to maintain financial stability by insuring depositors' funds in event where financial institutions can no longer meet their obligations. <http://ndic.org.ng/about-ndic.html> accessed 10.06.12 September, 2010); NDIC Annual Report and Statement of Accounts, 1999

<sup>37</sup> NDIC Annual Report and Statement of Accounts, 1999

[http://ndic.org.ng/files/NDIC\\_1999\\_ANNUAL\\_REPORT.pdf](http://ndic.org.ng/files/NDIC_1999_ANNUAL_REPORT.pdf) accessed 02.06.12

<sup>38</sup> Ibid

## 2.2 The Concept of ‘Corporate Governance’

Any attempt to explore the concept of corporate governance will also involve defining the term ‘governance’. It is important to state that the concept of ‘Governance’ is different from ‘Governing’ or ‘Government’, which involves a process whereby formal state structures and policies are determined and enforced.<sup>39</sup> The term ‘Governance’ is presently used as a concept which is all encompassing and capable of having numerous meanings not covered by the traditional notion of ‘Government’ that focus more narrowly on formal state structures and their operation<sup>40</sup>.

Richards and Smith examine ‘governance’ as a descriptive label used to describe the interaction of various actors involved in decision-making. The writers view ‘governance’ as collaboration of all actors and locations which go beyond the central government ‘core executive’ that are involved in policymaking process.<sup>41</sup> In view of this, it can be said that ‘governance’ is both a process and a system; and as with any system, it is made up of various actors and processes whereby each plays a role. It is important to note that whereas not all actors are part of the internal structure of the company, both internal and external actors play important parts in governance.

Rhodes (1997) identified six different meanings for ‘Governance’ that are currently used in contemporary social sciences. These are:

- The minimal State
- Corporate Governance

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<sup>39</sup> Gatto, A., 2006, The Law and Governance Debate in the European Union. Available at: [http://staging2.ilo.org/wcmsp5/groups/public/---dgreports/---inst/documents/publication/wcms\\_193614.pdf](http://staging2.ilo.org/wcmsp5/groups/public/---dgreports/---inst/documents/publication/wcms_193614.pdf) P.9 Last accessed 28.07.14

<sup>40</sup> Ibid p.9

<sup>41</sup> Richards and Smith (2002) as quoted by Leach, M., Bloom, G., Ely, A., Nightingale, P., Scoones, I., Shah, E. and Smith, A. (2007) *Understanding Governance: pathways to sustainability*, STEPS Working Paper2, Brighton; STEPS Centre P. 8 Available at: [http://www.stepscentre.org/PDFs/final\\_steps\\_governance.pdf](http://www.stepscentre.org/PDFs/final_steps_governance.pdf) Last accessed 28.07.14

- New public management
- Good Governance
- Social-cybernetic systems
- Self-organised networks<sup>42</sup>

Therefore contrary to the traditional model of government, Governance is used to mean a novel mode of government whereby both public and private actors as well as state and non-state institutions participate co-operatively in the formation and implementation of public policy. This emerging field of governance indeed connotes an abrasion of politically centred governance and nation-state constitutionalism<sup>43</sup>.

It is worth noting at this stage that for the purpose of this research, the concept of ‘Governance will be used to mean ‘Corporate Governance’, to be elaborated on below.

The term ‘corporate governance’ refers to a set of rules, regulations, policies and customs, which influence the management and control of corporate entities. Monks and Minow define corporate governance as ‘the relationship among various participants in determining the direction and performance of corporations.’<sup>44</sup> The major participants include shareholders, management (led by chief executive officer), and the board of directors; others include employees, customers, investors, suppliers and the society.<sup>45</sup>

Furthermore, the major definition extracted from the Cadbury Report views Corporate Governance as the ‘*system by which companies are directed and*

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<sup>42</sup> Rhodes, R., Understanding Governance. Policy Network Governance Reflexivity and Accountability 46–59 (1997). Available at <http://oss.sagepub.com/content/28/8/1243.pdf>  
Last accessed 28.01.14

<sup>43</sup> Gatto, A., 2006, (n.39) p.9

<sup>44</sup> Robert A.G. Monks and Nell Minow ‘Corporate Governance’ 2<sup>nd</sup> ed. Blackwell Business p.1

<sup>45</sup> Ibid

*controlled.*'<sup>46</sup> The Organization for Economic Corporation and Development (OECD)<sup>47</sup> 2004 principles proffered a broader definition. This definition sees corporate governance as a part of a larger economic context in which firms operates.<sup>48</sup> The OECD principles further describe corporate governance as a set of relationships between a company's board, shareholders and other stakeholders, which provides the system by which companies are directed and controlled.<sup>49</sup> This definition refers to corporate governance as a mechanism or system which must ensure transparency, accountability and control. The interrelationship between these actors will mean that a number of participants are involved in the goal of corporate governance, including regulators, auditors and employees.

John and Senbet also define corporate governance as the tool through which stakeholders exercise control over employees and management in order to protect their interests.<sup>50</sup> Generally, stakeholders are individuals or groups of people who are affected or likely to be affected by the organisation's decisions. Post et al define stakeholders as: 'Individuals and constituencies that contribute, either voluntarily or involuntarily to a company's wealth-creating capacity and activities and can therefore be said to be potential beneficiaries and or risk bearers of the company'.<sup>51</sup>

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<sup>46</sup> Section 2.5 of The 1992 Report of the Committee on Financial Aspects of Corporate Governance. Available at <http://www.ecgi.org/codes/documents/cadbury.pdf> Last accessed on 28.09.14

<sup>47</sup> See the 2004 OECD Principles available at <http://www.oecd.org/corporate/ca/corporategovernanceprinciples/31557724.pdf> last accessed 22.09.14. First released in May 1999 and revised in 2004, the OECD Principles form the basis for the corporate governance component of the Report on the Observance of Standards and Codes of the World Bank Group.

<sup>48</sup> This includes macroeconomic principles and level of competition. See OECD Principles Ibid at p.12

<sup>49</sup> OECD principles Ibid at p.12

<sup>50</sup> John, K, and Senbet L. (1998) Corporate Governance and Board effectiveness" in Farinha J. (2003) "Corporate governance. A survey of the Literature Centro de Estudos de Economic Industrial, do Trabalho da Empresa Faculdade de economia, Univeridade do porto: Portugal.

<sup>51</sup> Post, J.E., L.E. Preston and S. Sachs (2002). "Managing the Extended Enterprise: The New Stakeholder View," California Management Review, 45, 1 pp. 6-28 at p.8

O' Sullivan defines corporate governance as concerned with institutions that influence how business corporations allocate resources and returns. Corporate governance shapes WHO makes investments decisions in corporation, WHAT type of investments are made and HOW returns are distributed across stakeholders.<sup>52</sup>

Furthermore, according to G.O. Donovan, Corporate governance is:

‘an internal system encompassing policies, processes and people, which serves the needs of shareholders and other stakeholders by directing and controlling management activities with good business savvy, objectivity, accountability and integrity.’<sup>53</sup>

In corporate governance, the most prominent set of actors are the company directors. These can either be executive or non-executive directors. The ratio of executive to non-executive directors depends on the corporate governance codes, as well as the practice of individual companies, in the country in question. Generally, the non-executive directors tend to be retired executives or executives in other companies such that their capacity to provide independent scrutiny of the company results in a more robust governance process. All directors are responsible for the company's performance and behaviour and they must ensure the company complies with the regulatory measures in place, including accounting standards.<sup>54</sup>

Apart from directors, other actors in the company include shareholders, and in the case of banks, creditors, which include depositors and bondholders. By virtue of the economic agency relationship that exists between directors

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<sup>52</sup> O' Sullivan, M. (2003) *The Political Economy of Comparative Corporate Governance* 10(1) *Review Of International Political Economy* 23-72.

<sup>53</sup> G.O. Donovan: "A Board Culture of Corporate Governance, *Corporate Governance International*" Journal, Vol. 6 Iss.3 (2003).

<sup>54</sup> Source: <http://www.accaglobal.com/uk/en/student/acc-a-qual-student-journey/qual-resource/acc-a-qualification/p1/technical-articles/corporate-governance.html> Last accessed 29.12.14

and shareholders, many economists view shareholders as principals and directors as their agents.<sup>55</sup> As principals, shareholders are dependent on directors because they expect that directors act in their best interest and from a legal point of view, directors are to observe a fiduciary duty towards the company.<sup>56</sup>

According to the Cadbury Report, corporate governance seeks to improve accountability within an organisation, its success in this regard, is generally often assessed in terms of financial performance, for instance, return on investments or equity. It is important to note that performance of an organisation, however, does not in itself connote maximum financial results, or ability to generate optimum cash flows, but includes non-financial interests that come to bear in the company. The performance of quoted firms across the world is significantly influenced by non-financial interests including diversification, quality of service, workforce, development and organisational survival, a combination of which ultimately serves to influence financial performance of the company.

In an attempt to harness the aforementioned definitions, this thesis view corporate governance as an umbrella term relating to concepts, theories and practices of inter-relationships between various participants in the company ranging from boards to shareholders, regulators and other stakeholders. Unlike the day-to-day management of the company, corporate governance ensures the company operates in pursuit of its operational values, mainly targeted at helping the board function properly and in best interest of the company.

From the above definitions, it can be said that any attempt to define corporate governance should be jurisdiction-specific as many of the challenges of corporate governance are culture-bound. It is therefore

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<sup>55</sup> More on Agency relationship will be discussed in Chapter three.

<sup>56</sup> See generally CAMA 2004, s.279,

important to understand corporate governance within the ambit of the jurisdiction it involves in order to analyse the specific problems associated with it and ultimately suggest lasting solutions.

## **2.3 Corporate Governance in Banks**

### ***2.3.1 Early Banking Industry***

There is no gainsaying that banks are unique in terms of ownership, regulation and governance. The special attributes of banks no doubt has its consequences. In the early 19<sup>th</sup> century, banking and banking governance was relatively straight forward, however, by late 19<sup>th</sup> century, the UK alone had around 500 banks operating as unlimited partnerships and 700 building societies that were mutually owned co-operatives.<sup>57</sup> In the UK, early banking industry was a high-liquidity business with low concentration and low leverage.<sup>58</sup> There was also a mutually compatible balance sheet structure whereby equity capital comprised of almost half of liabilities and about 30% of banks assets involved cash and liquid securities.<sup>59</sup> Banking model during this period aligned with risk-taking incentives whereby the unlimited liability structure meant that control rights became the responsibility of investors with incentives to be prudent with depositors' money.<sup>60</sup> Also, there was also adequate market discipline whereby directors authorised transfer of shares to shareholders who also maintained liability after transfer of their shares; that way, checks and balance was exercised by each party.<sup>61</sup>

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<sup>57</sup> Cleary, E. J. (1965). *The building society movement* London: Elek Books; Collins, M. (2012). *Money and Banking in the UK: A History* (Vol. 6). Routledge.

<sup>58</sup> A similar banking system was practiced in the US and across Europe. See Haldane, A. G. (2012). Control rights (and wrongs). 32(2) *Economic Affairs*, 47-58.

<sup>59</sup> Haldane, Ibid 48

<sup>60</sup> Ibid

<sup>61</sup> Ibid 49



Soon, the global economy began to change and gradually, capital became restricted to a small amount of unlimited liability partners.<sup>62</sup> The 6 partner restriction rule was lifted in the UK in 1826 so that ownership and control could no longer be vested in a single-agent and banks began to operate as joint-stock companies.<sup>63</sup> Overtime, shareholder liability became limited, and shareholder discipline began to fade.<sup>64</sup> However, in the case of banks, limited liability was slow to kick-start. This is because unlimited liability served as a guarantee for depositors, knowing that their money is secured in a bank whose shareholders are accountable to them. However, according to Bagehot, the problem of unlimited liability was derived in its incentives whereby the wealthy assumed too much risk and lacked control, thereby preventing them from investing.<sup>65</sup>

With the collapse of City of Glasgow Bank in 1878, unlimited liability in banks became under attack as no shareholders became bankrupt while depositors lost nothing. Although, the subsequent Companies Act of 1879 provided for limited liability,<sup>66</sup> unlimited liability was still preserved in the form of extended liability which served to make shareholders liable in the event of insolvency or bankruptcy.<sup>67</sup> By virtue of this, both managers and shareholders were brought to book and made accountable.

Gradually, limited liability became rooted in the banking industry over the years. The last two decades witnessed a substantial increase as well as

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<sup>62</sup> Ibid

<sup>63</sup> Ibid

<sup>64</sup> Limited liability of shareholders began in the US in 1817 in Massachusetts. In the UK, the enactment of the Limited Liabilities Act and the Joint Stock Companies Act of 1855 and 1856 respectively brought a broad change to shareholder liability. See Haldane Ibid

<sup>65</sup> Bagehot, W. (1873). *Lombard Street: A Description of Money Market*, 1962 ed. Irwin, Homewood, IL.

<sup>66</sup> This subsequently reduced the number of banks with unlimited liability to two between 1849-1889 (Acheson, G. G., Hickson, C. R., & Turner, J. D. (2010). 'Does limited liability matter? Evidence from nineteenth-century British banking.' 6(2) *Review of Law & Economics*, 247-273)

<sup>67</sup> Haldane, A. G. (n.58) 48. Extended liability came in the form of reserve liability and uncalled capital. In the case of reserve liability, existing shareholders became liable in the event of bankruptcy while uncalled capital made pre-insolvency an option at the discretion of bank management.

imbalance in both risks and returns. Banks now differ in terms of distribution of risks and returns.<sup>68</sup> This is because while the responsibility of risks is borne by the society at large, returns on the other hand, are now borne by managers and shareholders.<sup>69</sup> According to Haldane, it is only in banking that control rights and incentive wrongs can be combined.<sup>70</sup> While CEOs across the globe earn exceptionally high income, the fall in share prices of banks across the world mean a decrease in the global economy and investment.<sup>71</sup> Although ownership and control rights are placed on shareholders, for banks, equity holders are often provided with a number of risk taking incentives not proportional to the interests of other stakeholders and the society. This then paved way for privatised interests and socialised risks.<sup>72</sup> This uneven distribution of risks and returns have grown over the years through a number of regulations and reforms targeted at lowering capital and also the rise of institutions that are ‘too big to fail’.<sup>73</sup> It can be said that the sudden rise in investor and managerial short-termism unravelled governance weakness in banks, thereby leading to the global credit crunch and banking crisis of 2007, the result of which is still being felt till date.<sup>74</sup>

### ***2.3.2 Development of banking activities in Nigeria***

Banking activities in Nigeria can be traced back to the period between 1892-1894 with the establishment of African Banking Corporation and First Bank

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<sup>68</sup> Ibid 47

<sup>69</sup> Ibid. According to Haldane, in 1989, the CEOs of the seven largest banks in the US earned around \$2-8 million, a figure almost 100 times the normal household income. However, by 2007, this figure had risen to around \$26million, almost 500 times the median household income.

<sup>70</sup> Ibid.

<sup>71</sup> Ibid

<sup>72</sup> Ibid

<sup>73</sup> Ibid

<sup>74</sup> Ibid

of Nigeria.<sup>75</sup> With the commencement of British control in the economy during the 19<sup>th</sup> century, the Colonial Banks were established in Nigeria to regulate commercial affairs, trade and financial activities from Nigeria to West Africa.<sup>76</sup> In 1925, a merger of the Colonial Bank, Anglo-Egyptian Bank and the Bank of South Africa saw the birth of Barclays Bank in Nigeria. Indeed the first indigenous bank to be created in Nigeria was in 1929 when the Industrial and Commercial Bank was established. However, the bank was short lived and later went into liquidation shortly after, precisely in 1930.<sup>77</sup> Its collapse was attributed to mismanagement, accounting malpractices, embezzlement and poor economy.

In 1931, Barclays bank was replaced by Mercantile Bank of Nigeria; sadly, it also went into liquidation six years later. In 1947, the Nigerian Farmers and Commercial Bank was established and in 1948, the British and French Bank for Commerce and Industry was established in Nigeria.<sup>78</sup> In 1949, African Continental Bank was established by Dr. Nnamdi Azikiwe, as a Pan African bank. The rate of establishment of the indigenous banks made the government appoint an official of the Bank of England, Mr. G.D. Paton to look into the Nigerian banking sector and make recommendations regarding the level of control to be introduced. The findings of the inquiry, submitted in 1952 led to the introduction of the first Banking Ordinance Act of 1952. The Act was established mainly to ensure orderliness in the banking sector and to prevent unregulated banking transactions.<sup>79</sup> In 1958, draft legislation for the establishment of the Central Bank of Nigeria was presented to the House of Representatives, which was later implemented on the 1<sup>st</sup> of July

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<sup>75</sup> First Bank of Nigeria was formerly known as Bank of British West Africa (BBWA). See Onoja, I.R. 'The Contributions of Research Development in the Banking Industry in Nigeria'.(1998) *Nigerian Journal of Management Research*, 210.

<sup>76</sup> Uche, C.U. 1999 'Foreign Banks, Africans and Credit in Colonial Nigeria' 1890-1912 52(4) *The Economic History Review* 669-691

<sup>77</sup> Brown, C.V., (1966) *The Nigerian Banking System* North-western University Press, Department of Business & Economics, p.1

<sup>78</sup> This later became the United Bank For Africa (UBA)

<sup>79</sup> See Alford, D. (2010) " *Nigerian Banking Reform, Recent Actions and Future Prospects*" University of South Carolina School of Law Coleman Karesh Law Library, p.2

1959 with the establishment of the Central Bank of Nigeria. It therefore suffices to say that the period from 1892-1952 can be said to be a '*Free Banking Era*' due to lack of banking legislation and banks were set up based on the Companies Ordinance Act of 1922 (as amended).

Deregulation of the finance and banking sector was introduced between 1959 and 1989 with the introduction of the Structural Adjustment Programme (SAP)<sup>80</sup> and this led to increase in the number of deposit banks, community banks, finance houses and People's and Mortgage Banks (Also known as Primary Mortgage Institutions). The Nigerian Deposit Insurance Commission (NDIC) was established in 1988 charged with the responsibility of ensuring safe banking practices and regulation, as well as insuring deposits for customers. The NDIC was also to assist the Central Bank in policy formulation and banking supervision.

Four major statutes have regulated Companies in Nigeria since 1900. The Companies Ordinance of 1912 was the first Local Company Statute in Nigeria. The Act was derived from the English Companies Act of 1908. It initially applied to the colony of Lagos but was subsequently amended in 1917 to extend operation to the rest of the country. The aim of the Act in particular was to: 'Provide for the formation of limited company within the colony and protectorates, and to foster the principles of co-operative trading and effort in the country'.<sup>81</sup> The Act also provided for the registration of Companies.

In 1922, a new Ordinance was enacted which merely consolidated the 1912 and 1917 Ordinances. The 1922 Ordinance governed commercial activities in Nigeria and witnessed series of amendments from 1929 to 1954. The

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<sup>80</sup> Nwabugo, N.E. (2011) "The Story of Structural Adjustment Programme in Nigeria; From The Perspective of The Organised Labour" *11(7) Australian Journal of Business and Management Research*. 30

<sup>81</sup> See generally the Companies Ordinance of 1912

Ordinance was incorporated into the Laws of the Federation of Nigeria (CAP 37) in 1958.

Following independence in 1960, the need to adapt with the growing trend of economic activities became prominent. The 1968 Companies Act therefore repealed the 1922 Companies Ordinance (as amended). The Act was well known for categorising companies as public and private, the minimum number for establishing a public company was seven and there was no maximum while for private companies, the minimum was two and maximum fifty. A major shortcoming of the Act was its failure to define a 'public company' while providing for the features of a private company.<sup>82</sup>

The independence of the country further envisioned the need to provide a more comprehensive legal framework that better meets the development needs of the country, particularly the promotion of indigenous companies. This necessitated the establishment of a Law Reform Commission to make recommendations on the future of the country's corporate sector while protecting the interest of investors, the general public and the nation as a whole.

The recommendations of the Law Reform Commission saw the birth of the Companies and Allied Matters Decree (now Act) 1990 (CAMA).<sup>83</sup> Part 1 and 2 of CAMA provides that it shall apply to all companies formed and registered under it, as well as all existing companies, all companies formed or incorporated under other enactments and also all unregistered companies.<sup>84</sup>

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<sup>82</sup> Section 28(1) of the Act provided that a Private Company is; 'One which its Articles of Association inter alia restricts the right to transfer its shares, limited the number of its members to 50 (excluding present and past employees), prohibited any invitation to the public to subscribe for any shares or debentures of the company'

<sup>83</sup> Now 2004.

<sup>84</sup> It is important to note however, that by virtue of Section 624 of the Act, Trade Unions and its employees are excluded from the scope of the Act.

It is important to mention that in Nigeria, corporate governance in banks is faced with the problem of regulatory multiplicity, resulting in conflicts within the codes.<sup>85</sup> Corporate governance regulation, as provided for in codes, is therefore different from actual corporate governance system of practice in banks. This difference arise from the gap between what ‘ought to be’ and what ‘is’. The problem, according to Osemeke and Adegbite can be attributed to the fact that the codes were copied from developed countries, particularly the UK and USA.<sup>86</sup> In their survey, the writers found that the conflict within the codes sends mixed signals as to compliance, presenting an opportunity to comply with less rigid codes or outright non-compliance as the case maybe.<sup>87</sup> This consequently creates an avenue for the perpetration of fraud whereby directors use regulatory weaknesses arising from conflicts within the codes as a fraud mechanism.<sup>88</sup>

#### **2.4 Conceptual Clarification of Fraud**

It is imperative to exegesis on various definitions attributed to fraud. This is necessary for a clear understanding of the concept and also to attain a foundational background of the nature of control fraud, which is the focus of this thesis.

According to Idolor, fraud can be defined as:

‘An act of deception aimed at gaining unlawful advantage;  
for any action to constitute fraud, there must be a  
dishonest intention to benefit (on the part of the

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<sup>85</sup> The problem of regulatory multiplicity will be expanded in the chapter on the role of regulation in corporate governance.

<sup>86</sup> Osemeke, L. And Adegbite, E. ‘Regulatory Multiplicity and Conflict: Towards a Combined Code of Corporate Governance in Nigeria.’ *Journal of Business and Ethics* p.1-21

<sup>87</sup> Ibid.

<sup>88</sup> Ibid.

perpetrator) at the detriment of another person or organisation'.<sup>89</sup>

Mahdi and Zhila<sup>90</sup> identify fraud as an

'Intentional misrepresentation, omission or concealment of truth for manipulation purposes to the financial detriment of either an individual or organisation and include theft, embezzlement or unlawfully obtaining or misusing the asset of either a person or an organisation'.<sup>91</sup>

Boniface<sup>92</sup> describes fraud 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 gain undue personal and monetary advantage.<sup>93</sup>

Fraud was defined in the old American case of *Wells V. Zenz*, as:

'A generic term which embraces multifarious means which human ingenuity can devise and is resorted to by one individual to get any advantage over another. It includes surprise, trickery, cunning and unfair ways by which another is deceived.'<sup>94</sup>

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<sup>89</sup> Idolor, E. J. (2010) 'Bank Fraud in Nigeria: Underlying Causes, Effects and Possible Remedies' 6(6) *African Journal of Accounting, Economics, Finance and Banking Research*, 62. 65

<sup>90</sup> Mahdi and Zhila, A., (2008) 'Fraud Detection and Audit Expectation Gap: Empirical evidence from Iranian Banks' 3 (10) *International Journal of Business and Management*, 65-67

<sup>91</sup> Ibid 65

<sup>92</sup> Boniface, C. (1991) 'Fraud in the Banking Industry' *The Nigerian Banker* Oct-Dec 22-23, CIBN Press

<sup>93</sup> Ibid, Chizea, B (1991) 'Frauds in the Banking Industry', *Journal of Chartered Institute of Bankers of Nigeria*, Oct-Dec ISSN0189-6679

<sup>94</sup> 1927 (83) Cal App.137 (236) 485.61

According to Owolabi;<sup>95</sup> fraud usually involves an act, omission and concealment taking the form of a breach of legal or equitable duty, trust or evidence resulting in damage to another through which undue and conscienceless advantage is taken. The term ‘fraud’ can therefore be said to be generic in nature. Fraud may be seen as any act or behaviour by one person with the intention of gaining an unlawful and dishonest advantage over another. This usually begins with the creation of trust, which is developed to a height where it is then eroded or betrayed. Fraud covers a number of crimes committed by corporations ranging from embezzlement to theft and misappropriation of funds to mention a few.

The distinctive nature of fraud differentiates it from other synonymous concepts such as treachery or cheat, which can also be regarded as components of fraud. Fraud is more affirmative in nature, involving deceit based on false representations or concealment of material facts whereby a person is being misguided by another to his advantage. The deliberate and intentional act with a wicked motive to cheat becomes central as a peculiar nature of fraud as opposed to its similar counterparts.

## **2.5 Taxonomy of Fraud**

The Serious Fraud Office (SFO)<sup>96</sup> identifies seven taxonomies of fraud. These include individual, corporate, charity and non-profit, market abuse, fiscal, public sector and supporting activities. An examination of corporate fraud as one of the taxonomies of fraud identified by the SFO is necessary to help unfold the peculiarities of control fraud that is later defined in the course of this chapter.

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<sup>95</sup> Owolabi, S.A. (2010) ‘Fraud and Fraudulent Practices in the Nigerian Banking Industry’ 4(3)(b) *African Research Review* 240. 244

<sup>96</sup> This is an independent Government department in the UK that focuses on prosecuting and investigating serious fraud and corruption. <http://www.sfo.gov.uk/> accessed 26 December 2014



Corporate frauds have been identified by the SFO to include the following:<sup>97</sup>

***2.5.1 Institutional Investment Frauds:***

This is the manipulation of institutions to make seemingly profitable investments, which, in the long run, becomes a fraud. Share sales, pension funds, ponzi schemes or pyramids and the like fall under this type of fraud.

***2.5.2 Corporate Services Frauds:***

These are frauds perpetrated by employees of the company or service providers. The types of perpetrators include lawyers and accountants. The SFO also identifies the sort of frauds that fall under this category, and they include procurement fraud, false accounting, personnel management, payment fraud, exploiting assets and information, travel and other expenses fraud.<sup>98</sup>

***2.5.3 Business Trading Frauds:***

This involves setting up businesses with the intention to defraud others. The frauds that fall under this category, according to the SFO, are insolvency and bankruptcy related frauds, long and short-term frauds.

***2.5.4 General Business Frauds:***

These are general day-to-day frauds that occur in businesses such as cheque overpayment scams, invoice scams, bogus government agency scams and charitable publication scams.<sup>99</sup>

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<sup>97</sup> SFO Taxonomy of Fraud <http://www.sfo.gov.uk/taxonomy.swf> last accessed 26 December 2014

<sup>98</sup> Ibid

<sup>99</sup> Ibid

### ***2.5.5 Banking and Credit Specific Frauds:***

This is fraud against the banking and credit industry committed directly or indirectly either through the banks or its employees. It comprises credit card fraud, cheque fraud, account/facility takeover and mortgage related fraud.

Other types of fraud further identified by the SFO include intellectual property frauds, insurance specific frauds, telephone specific frauds and gambling specific frauds.<sup>100</sup>

### **2.6 Fraud in Nigeria – 419 Advance fee fraud and others**

In Nigeria, corruption makes fraud evident in a number of ways that may not be obvious to the western world. According to Adeyemo<sup>101</sup>, the most common type of fraud in Nigeria is Advance Fees Fraud. This is popularly known as ‘419’ and was named after Section 419 of the Criminal Code CAP 77 LFN 1990. The section basically prohibits obtaining property by false pretence. By virtue of Section 419, any person who obtains property or credit by false pretence from another person and with the intention to defraud thereby incurring debt or liability by means of an entry into a debit or credit account between the person giving and receiving the credit is guilty of a felony and liable for imprisonment.<sup>102</sup>

As a financial fraud scam, Section 419 has been widely associated with the Nigerian state. According to Mustapha, the 419 industry has boomed over the last decade in Nigeria and has spilled even to neighbouring countries and beyond.<sup>103</sup> The scam involves fraudsters who use fake financial documents such as bank accounts, websites, company names and

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<sup>100</sup> Ibid

<sup>101</sup> Adeyemo, K., (2012) ‘Frauds in Nigerian Banks: Nature, Deep Seated Causes, Aftermaths and Probable Remedies’ 3(2) *Mediterranean Journal of Social Sciences* 279. 281

<sup>102</sup> Section 419 (a)(b) of the Criminal Code CAP (77) LFN 1990

<sup>103</sup> Mustapha, M, (2010) ‘Corruption in Nigeria: Conceptual and empirical notes.’ 3(2) *Information, society and justice journal* 165-175.

incorporation documents to solicit for help in transferring lump sum of money out of Nigeria using fake government documents. In the corporate world, 419 usually involve an agent introducing business offers to a person or company in return for the payment of an advance commission. The agent proposes very interesting financial gains and the victim in turn pays the commission in advance to the agent after which he disappears into thin air. More often than not, victims are aware of the dubious nature of the business but play along in the hope of financial gain at the end. Banks in distress and desperate for large funds are particularly prone to advance fees fraud, but after being defrauded, they are unlikely to report to the police in fear of being prosecuted as a 'partner to crime'.<sup>104</sup>

Recently, 419 scam has spread globally across countries such as Australia, Russia, Southeast Asia, New Zealand and the US; this is done in form of unsolicited letters received by major companies from people claiming to be employees of the Central Bank of Nigeria or the Nigerian Government.<sup>105</sup> The victims are then conned into sending money with the promise of profits and wealth beyond their imagination. The biggest case was recorded in 2007 in the largest city of Lagos where the Nigerian anti-fraud police revealed a multi-million dollar scam with about 15,000 fake cheques written to the value of \$4 million in the space of one month. Furthermore, lots of mails were discovered to have been sent by 'advance fees' conmen as well as forged financial documents and identification papers intended to bring their victims to the spider's web of seduction, conviction, addiction and desperation.<sup>106</sup>

Apart from 419, another method of fraud in Nigerian banks includes forged cheques whereby cheques are stolen, and signatures forged. This type of fraud is mainly perpetrated by insiders, that is, bank staff or in collusion

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<sup>104</sup> Adeyemo (Ibid) 281

<sup>105</sup> Mustapha (n.103) 171

<sup>106</sup> Source: BBC 30<sup>th</sup> October 2008. Available at:

[http://www.bbc.co.uk/blogs/watchdog/2008/10/the\\_419.html](http://www.bbc.co.uk/blogs/watchdog/2008/10/the_419.html) Last accessed 20.06.15

with outsiders as they come across cheques on a daily basis. It is usually targeted towards deposit accounts, savings accounts and in some cases company accounts.

In Nigeria, money-laundering fraud has also become prominent in the last two decades as a major form of fraud and means of financial embezzlement and is not limited to only outsiders. Money-laundering involves the use of illegally obtained money for untraceable transactions that tend to appear legitimate with the intention of concealing its source.<sup>107</sup> As a form of outsider fraud, money-laundering fraud takes the form of money transfer through moving finances to and from a bank to a beneficiary account in any bank worldwide. Means of perpetration could include telephone, over-the-counter, electronically or otherwise. The deceitful intention makes the transaction fraudulent for instance, alteration or changing of beneficiary's name or account details.

## **2.7 From white collar crime to control fraud**

The notion of control fraud can be said to originate from business crimes, otherwise known as 'white collar crime'. Edwin Sutherland was the first to examine this concept of 'white collar crime' as a term which embodies general corporate crimes relating to fraudulent business activities.<sup>108</sup>

The National White Collar Crime Centre defines white collar crime as:

'Illegal or unethical acts that violate fiduciary responsibility or public trust, committed by an individual or organisation, usually in the course of legitimate

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<sup>107</sup> Idowu, A. (2009) 'An assessment of Fraud and its management in Nigeria Commercial Banks' 10(4) *European Journal of International Sciences* 628. 630

<sup>108</sup> Sutherland, E. H, 1940 'White Collar Crime' 5(1) *American Sociological Review* 1-12 (being a paper presented at the thirty-fourth Annual Presidential address in Philadelphia on Dec. 27, 1939 (Fifty second annual address by President Viner)

occupational activity , by persons of high or respectable social status for personal or organisational gain'.<sup>109</sup>

The centre further identified four types of white collar crime, namely:<sup>110</sup>

- Personal Crimes committed outside a business for personal gain, for example, credit card fraud
- Crimes committed against an employer such as embezzlement
- Corporate crimes committed by a businesses
- Those who set up businesses simply to defraud others, for instance selling dubious investments.

From the above, it can be said that white collar crime is a non-violent, criminal activity based on financial mismanagement by people of high education, high social class and respectable character. Sutherland compares crime in upper or white-collar class which is made up of respectable business men who are also professionals with crime in the lower class, that is, persons of low social and economic status.<sup>111</sup>

He begins on the premise that in the past, white collar crimes are often seen as non-violent and as such viewed by the judiciary and police as less deviant, therefore lighter sentencing was given compared to violent crimes such as rape or murder. He goes on to note that although economists are well grounded in business methods, they fail to consider business activities from a criminal point of view and same goes for sociologists who are well knowledgeable in crime but not acquainted with its relationship with business. The aim therefore, was to integrate both schools of thought through a comparison of crime in upper or white collar class made of

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<sup>109</sup> The National White Collar Crime Centre, 1996 p.330. Available at <http://www.nw3c.org/> Last accessed 06.05.13

<sup>110</sup> Ibid 16

<sup>111</sup> Sutherland Ibid

respectable business personnel in a professional capacity and crime in the lower class made of persons with low socio-economic status.<sup>112</sup>

Sutherland goes on further on the statistics used by criminologists to generalise theories of criminal behaviour, particularly the conclusion that the concentration of crime in the lower class is associated with poverty and all poverty related factors.<sup>113</sup> This statement, although misleading when compared with the various conventional theories of crime and criminal behaviour, tends to present a central probability. Sutherland therefore puts on the argument that crime and indeed fraud is not closely associated with poverty. White collar crime in business usually takes the form of misrepresentation of financial statements and manipulation in the stock exchange, commercial bribery, embezzlement, misapplication of funds or tax frauds to mention a few.

Two elements have been identified as components of white collar crime, namely misrepresentation of assets and duplicity in the manipulation of power.<sup>114</sup> According to Sutherland, the first can be likened to fraud or swindling while the second is similar to double-crossing, for instance, a company director who, knowingly purchases a piece of land which he believes the company will need and sells it with good profit gain to the company. This concept of duplicity in manipulation of power arises where a person in position of authority holds two antagonistic positions, one of which involves trust and commercial honesty which is being breached. It should be mentioned, however that although, in complicated business relationships, it may be completely impossible to separate these antagonistic positions, the tendency to violate the delegated level of trust is of major concern.

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<sup>112</sup> Sutherland (n108) 1

<sup>113</sup> Criminal statistics confirms high occurrence of crime in the lower class compared to the upper class. Less than two percent of prisoners belong to the upper class. Ibid

<sup>114</sup> Ibid 2

An important point made by Sutherland is that the financial amount involved in white collar crime should not be construed to mean wealth as white collar in upper and lower classes merely serve as illustrations of persons of high and low socio-economic status.<sup>115</sup> This is because ‘white collar’ in this sense is used to mean ‘respected’, ‘socially recognised’ and ‘dignified’ and some persons of this class may not be well dressed or have high incomes. Accordingly, persons of low socio-economic status could be ‘white collar’ fraudsters to the extent that they are well comported and highly knowledgeable with high incomes.

The most important loss arising from ‘white collar’ crime is its effect on social relations, loss of trust and honesty. Central to ‘white collar’ crime is the weakness of their victims. Consumers, investors and stockholders who may be ignorant in protecting themselves usually are the victims of white collar crime and white collar crime usually blossoms where its perpetrators come in contact with persons who are weak as opposed to the many other crimes perpetrated against the wealthy and powerful such as burglary or robbery.<sup>116</sup> The wide margin of difference in victims accords some sort of relative immunity to perpetrators of white collar crime.

At the heart of white collar crime is the theory of differential association and social disorganisation. Differential association as examined by Sutherland views white collar crime as a process of invention whereby inventions are frequently made in order to assist in the perpetration of fraud.<sup>117</sup> The perpetrators are generally persons with good backgrounds and begin their careers with a level of idealism, working in businesses where criminality prevails and gradually become introduced to the system. The social disorganisation theory considers society as lacking in the organisation to tackle this type of criminal behaviour. Accordingly, the ‘rules of the game’

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<sup>115</sup> Ibid

<sup>116</sup> Ibid

<sup>117</sup> Ibid

in business conflicts with 'legal rules' leading to breach of business policies and ethics.<sup>118</sup> Consequently, the society fails to provide a solid mechanism and foundation in the opposition of crime and the result is persistence of white collar crime and commercial violations.

Furthermore, According to Reiman, the general public as well as policy makers are in constant support of practices that make the 'rich get richer and the poor get prison'.<sup>119</sup> Emphasis is mainly based on the delinquents of a stereotyped ethnic group of the society, neglecting the various boundaries between legal and illegal rules.<sup>120</sup>

Passas examines white collar crime as legal corporate crimes.<sup>121</sup> According to him, by focusing on activities that are classified by the society as criminal and illegal, there is a diversion from a more injurious threat to the society. This is the threat posed by corporate activities that are legal, yet with serious implications to the society, creating a lawful but awful environment for corporate crime.<sup>122</sup> A distinctive attribute is the ability to oppose criminalisation, while preventing regulatory attempts aimed to curb the harmful effects of their activities.<sup>123</sup> Cross border violations are a suitable example of crimes without law breaking. The boundaries of law enforcement and legal jurisdictions allow offenders to commit crimes that are prohibited in their home countries in other jurisdictions without breaking any law and ignorance of off-shore corporate structures can be used to shield both the company and executives from prosecution.<sup>124</sup> By so doing,

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<sup>118</sup> Ibid

<sup>119</sup> Reiman J, (2000) *The Rich Get Richer and the Poor Get Prison*, 6<sup>th</sup> ed, Boston: Allyn and Bacon

<sup>120</sup> Passas, N. Transnational Crime, The interface between legal and illegal actors: Presented in the National Research Council Workshop on Transnational Organised Crime, Washington DC, Passas, N. (ed) 1999a Transnational Crime, Dartmouth, Aldershot,

<sup>121</sup> Passas, N. (2005). 'Lawful but awful: 'Legal corporate crimes'. 34(6) *The Journal of Socio-economics*, 771-786.

<sup>122</sup> Ibid

<sup>123</sup> Ibid 776

<sup>124</sup> Ibid 774



corporate transactions that are prohibited in one country can be transferred off shore to countries with friendlier corporate regulations.

Going from the above, one can conclude that ‘Crime in the Suites’ victimizes more people than street offenders.<sup>125</sup>

## 2.8 Control Fraud Defined

The term ‘control fraud’ is defined as a wave of frauds led by the people who control large corporations causing massive losses and great systematic damage.<sup>126</sup> In his book: *‘The Best Way to Rob a Bank is to Own One’*, Black examines control fraud in the public and private sector. He explores how corporate executives use companies<sup>127</sup> to defraud, fooling the most sophisticated market participants and experts.<sup>128</sup> According to him, control fraud refers to fraud in which those that control (typically the CEOs) an entity use it as a ‘weapon and shield’ to defraud.<sup>129</sup>

As earlier explained, fraud is theft by deception; the perpetrator creates and then exploits trust to cheat others, therefore eroding the trust.<sup>130</sup> Deceit and betrayal, therefore, become pivotal to control fraud. Furthermore, control fraud is premised on trust and betrayal. Trust is necessary in effective relationship among markets, politics and societies. Trust is therefore vital to any society and it is important for business and market transactions. Fraud therefore destroys trust. In corporate governance, trust is necessary for

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<sup>125</sup> Black, W. K.. (2005) *The Best Way to Rob a Bank is to Own One* Texas: University of Texas Press page 7-8. William Black is the first person to use the term ‘control fraud’ as a type of fraud perpetrated by corporate executives in public and private sectors.

<sup>126</sup> Ibid

<sup>127</sup> The word ‘company’ for the purpose of this chapter mean ‘bank’ and will be used interchangeably through the thesis

<sup>128</sup> Ibid

<sup>129</sup> Ibid, Chapter 1 considers control fraud as a form of theft by deception in the savings and loan industry. See also Black, W. K. ‘Epidemics of Control Fraud Lead to Recurrent, Intensifying Bubbles and Crises’. *Intensifying Bubbles and Crises (April 15, 2010)* <http://www.franzhoermann.com/downloads/black-control-fraud.pdf> accessed 27 December 2014

<sup>130</sup> Black, W. K. (n.125) 1.

healthy relationship among actors such as shareholders, directors, and other stakeholders.

Black describes control fraud as crimes led by the CEO, who uses the company as a fraud vehicle.<sup>131</sup> He identifies the CEO as a financial super-predator who uses accounting fraud as a weapon and shield to perpetrate fraud and try to avoid prosecution.<sup>132</sup> It is important to mention that Black refers to perpetrators of control fraud as ‘control frauds’.<sup>133</sup> Furthermore, recklessness is the trait that sets control fraud ablaze, this is premised on the fact that any individual in control of a bank could commit control fraud but it is the audacity to actually go ahead with it that becomes legendary.<sup>134</sup>

Control frauds can be seen as viruses that control the body and turn it into a reproductive system for their infections.<sup>135</sup> Just like viruses, control frauds must find a way to overcome the body’s immune system, that is, internal controls in place and corporate governance regulations. Control frauds must develop a way to paralyse the immune system so as to be able to infect the virus into their predators.<sup>136</sup> Control frauds reconstruct the corporate environment to help their frauds. This is done by securing accounting abuses in order to weaken regulatory measures.<sup>137</sup>

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<sup>131</sup> Black, W. K. (2005) ‘When fragile becomes friable: Endemic control fraud as a cause of economic stagnation and collapse.’ In *IDEAS Workshop: Delhi, India, Financial Crime and Fragility under Financial Globalization, December 19-20*

<sup>132</sup> Ibid; Black, W. K. (2005). “Control frauds” as financial super-predators: How “pathogens” make financial markets inefficient.’34(6) *The Journal of Socio-Economics*, 34(6), 734, 739

<sup>133</sup> Black, W. K.. *The Best Way to Rob a Bank is to Own One* (n.125)

<sup>134</sup> A good example of a notorious control fraud is Charles Keating who ran American Continental Corporation and Lincoln Savings and Loan Association in the 1980’s taking advantage of flexible restrictions on bank investments. Subsequently, he collided with five U.S senators (dubbed the Keating five) for preferential treatment from the regulators and upon failure; he was convicted of fraud, racketeering and conspiracy. (Black ‘*The Best way to rob a bank is to own one*’(n 125) xvii)

<sup>135</sup> Black, ‘Control Frauds as Financial Super predators’ (n. 132) 6

<sup>136</sup> Ibid

<sup>137</sup> Black, W. K. (n.125) 3

It is important to mention that control fraud is a particularly serious form of white collar crime, or blue-collar thieves as identified by Black.<sup>138</sup> This is because they cause The CEO poses the greatest fraud risk, causing systemic corporate failure and ultimate economic injury. He directs the fraud, making it difficult to detect and punish. According to Black, this is achieved by structuring stock options to maximize their own interest and using it as a weapon to convert company's assets for personal use. Directors camouflage the fraud, using accounting manipulation to make illegitimate practices appear legal. Black illustrates control fraud with side mirrors that appear to reflect so normal that the government requires a protective warning on a permanent basis to be attached to them: 'Objects in this mirror are closer than they appear.' Surely, catastrophic insolvency is closer than it appears for control frauds.<sup>139</sup> Therefore, the impact of control fraud is often greater than other types of frauds, in banks; it can cause massive business failures in waves that jeopardize the economy as a whole<sup>140</sup> and expose taxpayers to huge liabilities, either under deposit guarantee schemes or by causing losses to banks in situations where the central bank provided liquidity against assets (loans) of questionable quality.

Pontell explains control fraud as a criminogenic environment which aids perpetration of criminal activities, and ultimately lead to proliferation of control fraud as in the savings and loans crisis. According to him, a number of factors facilitate control fraud:<sup>141</sup>

- Complete insider domination ('The best way to rob a bank is to own one')
- Conversion of corporate assets for personal gain

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<sup>138</sup> Ibid 16

<sup>139</sup> Ibid

<sup>140</sup> Ibid

<sup>141</sup> Pontell H.N., (2005) 'Control Fraud, Gambling for Resurrection and Moral Hazard: Accounting for White Collar Crime in the Savings and Loan Crisis'. *34 The Journal of Socio-Economics* 756-770, p.764

- Concealment of losses by investing in assets that have no readily ascertainable value which is then overstated and loss hidden
- Ability to evade detection in the perpetration of fraud by fronting fraudulent transactions as ‘normal’
- Irrational liquid assets compared to liabilities (the larger the amount, the more that can be looted)
- Ability to create a rapid growth of the corporation
- Minimal ethical standards (where greed is considered a virtue and governmental regulations unnecessary)

From the above, it can be said that control fraud involves seemingly legitimate corporate transactions that tend to go unnoticed for a significant period of time. It is important to consider the theories of control fraud in order to shed more light on the peculiarities of this kind of fraud.

## **2.9 Theories of Control Fraud**

As earlier explained, in the banking sector, the likelihood of control fraud is higher. According to Comer, when two people meet to discuss money belonging to a third, there is a risk of fraud.<sup>142</sup> Fraud appears to be impalpable and unstructured to which its complicated nature cannot be over-emphasized. However, perpetrators are constantly faced with constraints in committing fraud. This is because they have no choice or control over the environment in which they operate. Thus, the interrelationship between the society and fraud pattern creates behaviours and practices that define perpetration of fraud and from which various deductions can be made.

In his book, Comer sheds important light on the theories to which the complexities of control fraud can be understood.<sup>143</sup> Although the writer

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<sup>142</sup> Comer, M., J. (1986) *Corporate Fraud* 2<sup>nd</sup> edition Berkshire: McGraw-Hill Book Company p.14

<sup>143</sup> Ibid

examined corporate fraud, his analysis parallels with the work of Black. These theories are examined below:<sup>144</sup>

- Differential Opportunity
- Theory of Concealment
- Theory of Deviation
- Theory of Collusion

### ***2.9.1 Differential Opportunity:***

According to Comer, the differential opportunity theory suggests that given certain factors, people have the tendency and opportunity to commit fraud, either against their employer, against suppliers and customers of their employers, against third parties or against government departments.

However, availability of this opportunity is guided by three main factors:

1. Level of access given to the perpetrator to assets, properties, accounts and computer systems
2. Possession of adequate skill required to identify the existence of such opportunity and means of exploitation
3. Utility of sufficient time in planning and execution of the fraud.

A large amount of control fraud is usually caused by breach of trust either by management or employers to whom access is granted. 'Access' can, therefore, be said to be the most significant factor in the theory of differential opportunity and is described below:

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<sup>144</sup> Ibid 23.

**Table 1: Access to Fraud Opportunity**

<b>Access Level</b>	<b>Fraud Achieved by</b>
Authorized access granted through managerial role or employment	Breach of Trust
No access	Access granted by skill or collusion

Source: Comer 1986<sup>145</sup>.

It is important to stress that the position of the CEO poses the greatest risk for control fraud considering the above attributes such as access, skill and time coupled with control and power. The CEO or Managing Director as the case may be, is the highest placed corporate officer or executive charged with the management of the company.<sup>146</sup> Being the head of the executive management, the CEO's training, knowledge, skill and experience becomes vital to his appointment, duties, powers and responsibilities.<sup>147</sup> He is therefore given adequate access and opportunity as he is empowered with specific managerial duties and responsibilities delegated to him by the board.<sup>148</sup>

In *Re Newspaper Proprietary Syndicate Ltd*<sup>149</sup>, the English courts considered the position of a managing director as:

‘... Ordinary director entrusted with some special powers. These special powers may be as broad or as strictly defined as the directors choose. The directors may ... Delegate to any managing director ... such powers as they

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<sup>145</sup> Ibid 24.

<sup>146</sup> The term ‘CEO’ also means ‘Managing Director’ in English terms. Mackenzie, I. (2006) ‘Professional English in Use – Finance’ Cambridge; Cambridge University Press, page 16

<sup>147</sup> SEC Code of Corporate Governance for Public Companies, 2011 s.5.2

<sup>148</sup> Ibid s.5.2(e)

<sup>149</sup> (1990) 2 Ch. 349

consider desirable to be exercised by him. Any such delegation may be made subject to any conditions the directors may impose and either collaterally with or to the exclusion of their own powers and may be revoked or altered.’<sup>150</sup>

From the above, it can be said that the broad powers and duties of directors as provided in common law are not in themselves sufficient to protect dispersed shareholders or taxpayers against control fraud. It is no news that the position of the CEO as a managerial role creates the opportunity to carry out control fraud in the company. Their level of skill and intelligence can be used as a tool and weapon for control fraud. Effective management and day-to-day running of the company is the responsibility of the CEO who can therefore be said to be in ‘control’ of the company. The main duty of the CEO is to lead the company by abiding by internal systems and regulations. He is also charged with the responsibility of encouraging all employees to carry out activities in accordance with prescribed policies and regulations. Being a very significant personality in the bank, they are considered to be at the top of power. They could thus become influential, not only to the bank alone but to the nation’s economic, financial and even political futures as the case may be. The position of ‘Control’ occupied by the CEO becomes a vital tool for the perpetration of fraud.

In Nigeria, as in most jurisdictions, those appointed as CEOs, are long-serving professionals with requisite skills and experience and have held senior managerial roles.<sup>151</sup> Section 263 (5) of the CAMA empowers

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<sup>150</sup> Ibid C.J. (2011)

<sup>151</sup> For instance, Mr Benard Ojeiofo Longe, CEO of First Bank of Nigeria Plc in 2001, who was a director of the bank prior to his appointment as CEO, Mallam Suleiman Umar, CEO of Continental Merchant Bank Nigeria Plc from 1987-1992 who was a former executive director at the bank (Aburime, T. U., Gannon, G. L., & Corrado, C.J. (2011) ‘How long should Bank CEOs continue? Evidence from Nigeria.’ 34 [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1970184](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1970184) accessed 22 December 2014). Also, as will be seen in the course of this thesis, the CEOs of the five banks were long serving professionals.

directors to delegate any of their powers to a managing director who shall be any member of the board that they think fit and in exercise of the powers so delegated, the managing director shall conform to any regulations set out by the directors.<sup>152</sup> They are, therefore, appointed to serve the company and should be accountable to both the board of directors and the company as a whole. Although the intention of the Act, coupled with subsequent corporate governance regulations was to create avenue for checks and balances within the system, this was clearly not enough in preventing the banking crisis. The problem of accountability of the CEO remains a very controversial issue across the world.

### **2.9.2 Theory of Concealment:**

Concealment as a theory of fraud remains a very important factor that plays a significant role in many corporate frauds and is also a fruitful element in fraud detection owing to permanent and predictable traces. The basic objective of fraud is to gain personal and dishonest advantage. Krauss and Maccahan<sup>153</sup> consider important factors of fraud; namely Dishonesty, Opportunity and Motive. With this motive being greed, the perpetrator usually tries to hide any possible evidence that may expose or suggest their responsibility. According to Ovuakpourie,<sup>154</sup> three elements are central to fraud: The *will* to commit fraud, The *Opportunity* to execute the fraud and The *Exit*, which is the escape route to conceal the fraud. These three elements are readily available to control frauds, presenting a fraud-friendly environment.

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<sup>152</sup> This appointment must however be subjected to approval by the CBN before their assumption of office. (Banks and Other Financial Institutions Act, 1991 s.44(1) ). It must be stated that CAMA does not provide for remuneration committee but rather gives power to the directors. Remuneration in terms of salary, profits or commission is also to be determined by the directors. (Companies and Allied Matters Act, 2004 s.268 (1))

<sup>153</sup> Krauss, I. I. and A. Maccahan (1976). *Computer Fraud and Countermeasures* Baltimore: America Fidelity and Guarantee Company

<sup>154</sup> Ovuakporie, V (1994) *Bank Frauds; Causes and Prevention: An Empirical Analysis*, Lagos: ATI Books



Central to the theory of concealment is the element of confusion, which the perpetrator usually deliberately introduces before, during or after the fraudulent act. Non-concealment of fraud may lead to imbalances between physical inventories and accounting records otherwise known as Account / Inventory discrepancy. However, as identified by Comer,<sup>155</sup> concealment of fraud may not be necessary when:

- The victims' records may not disclose the loss
- Where the loss is identified, there are insufficient records to identify the perpetrator
- The victims condones the fraud

In effect, what is indeed being concealed is the discrepancy in accounting records and this is achieved through misrepresentation and manipulation. While manipulations involve falsification of accounting records, misrepresentations include falsification of commercial or personal realities either before, during or after the fraud in order to assist in its perpetration or to conceal facts.<sup>156</sup>

### ***2.9.3 Theory of Deviation:***

According to Comer, the deviation theory is based on the fact that fraud is a deviant behaviour and perpetrators often conceal their dishonesty and guilt.<sup>157</sup> This occurs when the pressure to overcome their limitations results in plausible deviations or breach of policies and procedures and usually, this is the first sign that a fraud has been committed. Identification and explanations of all plausible deviations from accepted policies and behaviours studied from perpetrators point of view may reveal evidence of fraud.<sup>158</sup> In control frauds, it is interesting to see that the CEO as the one

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<sup>155</sup> Comer (n 142) 25

<sup>156</sup> Ibid

<sup>157</sup> Ibid 27.

<sup>158</sup> Ibid

ultimately in charge of the company is faced with the pressure to make returns on investments, and this could open door to illegal risks taken and breach of accounting rules. According to Black, control frauds see these practices as ‘clever’ or ‘innovative’ rather than immoral.<sup>159</sup> It should be mentioned that in the battle to showcase a fast growing company, breach of policies and procedures become almost normal in the face of financial performance.

#### ***2.9.4 Theory of Collusion:***

Collusion is a very common element of fraud and can occur either as minimum or general (institutionalized) collusion.<sup>160</sup> Minimum collusion is paramount in high scale manipulative frauds whereby a few people are required for the necessary skill, opportunity and will to perpetrate an act or gain access to property or records. General or institutionalized collusion, on the other hand, involves low skill, common criminal motive and a large number of people.<sup>161</sup> These include employees who consider themselves to be in ‘the same boat’, therefore reducing the risk of detection or whistle-blowing. However, it should be mentioned that for control fraud to occur, more often than not, both minimum and institutional collusion are required in the wave of perpetration. This is because different categories of persons are needed in order to provide an illusionary liquid company with the aim of attracting investments, thereby creating more avenues to perpetrate fraud. Maintaining this web of frauds will require collective participation of a large number of people from top and bottom positions with a common goal to defraud.

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<sup>159</sup> Ibid 284

<sup>160</sup> Ibid 28.

<sup>161</sup> Ibid

## **2.10 The Mechanics of control fraud**

It is important to state that although control fraud has been identified as a type of fraud, it is however, different from the ordinary fraud that is well known, that is, the type associated with corruption and embezzlement; nevertheless these are also attributes of control fraud. The difference lies in the mode of operation of control fraud. While both types of fraud involve the use of opportunities for personal gain, control fraud mainly occurs in the banking sector and it requires a more in-depth knowledge and skill. It becomes imperative to examine the mechanics of control fraud that distinguishes it from other types of fraud.

### ***2.10.1 The ‘Yes-Men’***

As control freaks, control fraudsters create what Black calls a ‘fraud friendly’ corporate environment, shopping for yes-men which includes accountants, auditors, lawyers and employees that can be manipulated as profit centres.<sup>162</sup> They use excessive pay packages, intimidation and anxiety to get employees who will submit to the CEO.<sup>163</sup> Control frauds manipulate employees with constant praises to sweep them off their feet, turning them to loyal disciples, otherwise known as yes-men who will spread their message of success. According to Black, bonuses are given for being ‘creative’.<sup>164</sup> Creative in this sense is nothing more than inventing new ways of by-passing accounting rules, staying back at work to get new goodwill acquirers for mergers and conversions.

As financial super-predators, control fraudsters are particularly skilful in identifying and exploiting human weaknesses.<sup>165</sup> In Nigeria, the ongoing wave of control fraud in banks reveals that the CEOs succeeded in getting at

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<sup>162</sup> Ibid 2

<sup>163</sup> Ibid

<sup>164</sup> Ibid 282

<sup>165</sup> Ibid 2

least one clean audit opinion and this routine goes on for years. The external auditor therefore becomes the most valuable accessory to control fraud.<sup>166</sup> Generally, well-run companies do have adequate internal and external mechanisms targeted at preventing crimes. However, the CEO, as the person ultimately in charge of the company, could bypass all of these measures and controls. Not only do the CEOs beat control mechanisms, they influence and turn them into accessories.<sup>167</sup>

### ***2.10.2 The Fraud Vehicle – An Arm’s-length Transaction***

Another destructive mechanism employed by control fraud is the optimization of the bank as a fraud vehicle, which can therefore be used to optimize the corporate regulatory environment. Black examines the seemingly arm’s-length (independent) transaction considered by accountants as the best evidence of value which involves using an elegant fraud mechanism whereby control fraudsters transact with each other on a seeming arm’s-length basis when actually they are engaged in massive overvaluation and manipulation of assets so as to create sensational incomes, fictitious profits and hide real losses.<sup>168</sup> As predators, they ‘spot and attack’ human regulatory weaknesses to their advantage. They cause the firm to invest in transactions that can be used for perpetration of fraud, that is, transactions without readily ascertainable market values and utilise professionals as superior vehicles, flaunting themselves as legitimate leaders, while moving the company to the best level suitable for weak regulation and accounting fraud. According to Black, only control fraud can

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<sup>166</sup> Although it has been argued that it would be irrational for any top listed audit firm to put its reputation on the line by ‘blessing’ financial statements tendered by a control fraud, (Prentice, Robert, 2000 ‘The Case of The irrational Accountant: A behavioural Insight into Securities Fraud Litigation’ 95(1) *North-western University Law Review* 133 at 136-137) ) whether or not this is the case in Nigeria is very controversial and the chapter on Auditors’ involvement in the crisis will examine this issue detail.

<sup>167</sup> Ibid

<sup>168</sup> Black W. K. (n 125) 2

use the full resources of the company to buy, bully, bamboozle or bury the regulators.<sup>169</sup>

In Nigeria, this method of fraud usually involves inflation of assets or omission of liabilities with the intention of inflating the company's financial performance. It is often difficult to discover this as CEOs often leave no apparent clues for detection and more often than not, the people involved have a longstanding level of established trust and honesty. Many organisations quoted on the Nigerian stock exchange have the most prevalent level of this kind of fraud as they would want to appear and look good to the outside world so as to attract both local and foreign investment. This method of control fraud is usually exposed with cases of sudden failure or insolvency of banks with published records of sound financial performance till the end.

A good illustration of this would be the case of Oceanic bank Plc and Intercontinental Bank Plc analysed subsequently in the course of this thesis. The basis for manipulation of accounts is premised on enhancing the performance of the banks with unearned profits in order to deceive investors as to the proper management of the organisation and its financial position, and possibly increase pay packages of CEOs involved.<sup>170</sup> Skilful concealment is involved in the utilisation of this method to perpetrate fraud and it commonly involves manipulation of 'cut-off' procedures, which are laid down as a means of checks and balances to ensure correlation between purchase records and stocks following the end of an accounting period.<sup>171</sup> In

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<sup>169</sup> Ibid 3

<sup>170</sup> A good number of the companies that collapsed in Nigeria between 1994-2005 were reported to have been involved in manipulation of accounts. For instance, the case of Cadbury Nig. Plc where the Managing Directors also held the combined positions of CEO and Chairman of the Board and accounts were overstated by more than 1 Billion Naira or unearned profits, which upon intervention of the SEC exposed the real losses in the company. <http://www.nairaland.com/126888/cadbury-plc-akintola-william-union> accessed 22.01.15. Other international cases include Enron, Vivendi, Global Crossing and Tyco.

<sup>171</sup> Iwu-Egwuonwu R., C. (2011) 'Behavioural Governance and Corporate Governance quality' 3(1) *Journal of Economics and International finance*. 7. See also the popular

effect, the aim is to ‘bolster’ or ‘shore-up’ a company in an unsecure financial and managerial position as a tool for maintaining confidence of shareholders, creditors and investors.

### ***2.10.3 Looting of funds***

Control frauds create a ‘legitimate’ atmosphere for the CEO to divert a company’s assets to their personal gain. In Nigerian banks, one of the most efficient fraud mechanisms in control fraud is for the CEO to ‘loot’ cash from the bank, which is mostly done by defrauding the bank by indirectly borrowing money to fictitious lenders linked to the CEO (which would subsequently become non-performing) and wiring the money to other accounts at an offshore bank, thereby leaving valueless assets but real liabilities. As will be examined in later chapters, it can be said that most of the top five cases of control fraud in Nigerian Banks were guilty of fraudulent diversion of funds for personal gain.<sup>172</sup>

Looting of cash in Nigeria is not new, especially in the public sector where monies meant for projects are often shared between officials. Looting can also be done through excessive pay packages as will be seen in the case of the CEOs. Reckless spending is also a prominent means of looting whereby

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English case of *Re Thomas Gerard and Sons Limited* (1986) CH. 455 which is quite an interesting example of fraudulent manipulation of accounts whereby the managing director of a limited liability company adopted the use of cut off procedures leading the company to pay dividends in error out of capital to the amount of £26,254 and also pay £56,659 in excess of its liability.

<sup>172</sup> As will be seen in chapter four, the CEOs of these banks illegally transferred bank funds to different parts of the world. The strategy of outright stealing of cash would mostly appeal to people ready to go on the run to exile when things go wrong. For example Marc Rich, an international American business man who had gone into exile without an extradition treaty when he was indicted on 65 criminal counts, including wire fraud and racketeering which could have led to a sentence of more than 300 years in prison had he not been granted presidential pardon by Bill Clinton in 2001 ( *The Economist*, ‘Marc Rich, King of Commodities, died on June 26<sup>th</sup>, aged 78 ( London 6 July 2013) <http://www.economist.com/news/obituary/21580438-marc-rich-king-commodities-died-june-26th-aged-78-marc-rich> accessed 26.01.15 )

a ridiculous amount of money is being utilised for projects with connected parties which then become unaccountable.<sup>173</sup>

Because accounting frauds are the weapon of control frauds, fictitiously inflated incomes would hide losses of companies with the most likely insolvency tendencies, giving room for control frauds to divert a company's funds for their personal gain through means that appears to be legitimate and with the use of simple tools such as stock bonuses. The CEO tends to maximize the apparent legitimacy of his actions to the extent that ordinary individuals, economists, shareholders or auditors cannot simply imagine the rationality behind a CEO ever conceiving to defraud 'his' own company. Nigerian CEOs, particularly those who run top companies receive large pay packages and bonuses and report awesome profits tendering financial statements that have been 'blessed' by auditors. It thus follows that the profitability of the firm would warrant a presumption that the firm and auditors are acting with integrity.

## **2.11 Notable cases of control fraud across the globe**

### ***2.11.1 The US Savings and Loans Debacle of the 1980's***

One of the worst financial disasters of the 1980s is the Savings and Loans crisis, which led to the largest recorded financial loss in America. Calavita et al reveals that by the end of 1990, a total of 680 organizations were reported to be insolvent and thousands of criminal cases had been reported to the state crime department and over \$150 billion was spent on resolution costs.<sup>174</sup> As a governmental response to the crisis, a majorly funded research was launched on the savings and loans debacle to investigate the extent of loses attributed to fraud in the 1980's. The research utilised data from law

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<sup>173</sup> A good example is Intercontinental bank Plc (discussed in chapter four) where the board were alleged to have spent a total of N85million on 'feasibility studies' regarding opening new branches outside Nigeria.

<sup>174</sup> Calavita, K., Pontell, H.N., Tillman, R., (1997). *Big Money Crime: Fraud and Politics in the Savings and Loans Crisis* Berkeley:University of California Press

enforcement agencies and regulatory bodies. Pontell considers the findings of the research and noted that fraud and crime were at their peak in the country in the 1980's which led to the collapse of various institutions leading to taxpayer bailout.<sup>175</sup> Of all the issues that emanated in the periods after the crisis, the role of fraud stood out. It became imperative to know what role fraud played in the crisis, making it the worst of its kind. This became the subject of discussion for academics, media as well as the government. Various accounts of crime were used to explain the crisis and how white collar crime coupled with other economic factors such as managerial incompetence, regulatory weakness, risk taking and the likes led to the grave amount of loss in the savings and loans crisis.<sup>176</sup>

While it would be an error to attribute too much weight to the role of fraud, to underestimate its prevalence would amount to a judgement error.<sup>177</sup> In this regard, it is important to distinguish control fraud as a new and emerging concept developed in the wake of economic gains during the periods leading to the savings and loans debacle. This distinction according to Pontell is based on previous research differentiating corporate crime, whereby a company commits fraud on its own behalf, and embezzlement where financial crime is committed against a company.<sup>178</sup>

According to Calavita and Pontell, control fraud might have been discovered in the form of collective or collaborative embezzlement during the savings and loans debacle, which had not been examined by legal and criminological analysts at the time.<sup>179</sup> Sutherland considers the ordinary case of embezzlement in white collar crime as crime perpetrated by one

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<sup>175</sup> Pontell H.N. (n.141)

<sup>176</sup> Calavita et al Ibid, Black, W.K., Calavita,K., Pontell, H.N., (1985), The Savings and Loans Debacle of the 1980's: White-collar Crime or risky business? *Law and Policy* 17(1) 23-55

<sup>177</sup> Calavita et al Ibid, Balck et al Ibid

<sup>178</sup> Pontell 2005 (n.141) 762

<sup>179</sup> Calavita, K., Pontell, H.N.,(1991) 'Other People's Money Revisited: Collective Embezzlement in the Savings and Loans and Insurance Industries' 38(1) *Social Problems* 94-112



individual who is in a subordinate position against a corporation.<sup>180</sup> However, collective embezzlement, (which will later become control fraud) is different from the traditional notion of embezzlement and it involves outright looting or diversion of funds from an organisation by its top management.<sup>181</sup> Therefore, as opposed to a low level type of fraud collective embezzlement involves corporation management in the corporate web and those in control who conspires with both insiders and outsiders to defraud the corporation.<sup>182</sup> Organisational support is a tool for collective embezzlement. According to Pontell, collective embezzlement can be said to be a crime by the corporation against the corporation.<sup>183</sup>

Furthermore, apart from outright looting of funds, collective embezzlement also involves fraudulent business activities for personal gains to the detriment of the corporation.<sup>184</sup> This includes all form of ways devised by management to rob their own organisations such as excessive pay packages involving holidays, travelling in private planes, buying expensive houses, yachts, etc.<sup>185</sup> A more subtle form of collective embezzlement which can be easily concealed involve excessive executive compensation, inflation of accounts and fabrication of profits in order to attract more investments.<sup>186</sup> However, Black in his book confirmed that control fraud was actually prominent during the savings and loans debacle of 1990, leading to catastrophic loss in the industry. According to him, majority of the debacle can be attributed to bad regulation, particularly; the prohibition of adjustable-rate mortgages which was meant to reduce interest-rate risk; which made S&L insolvent in market value, therefore it was cheaper for

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<sup>180</sup> Sutherland, E., H. (1949), *White Collar Crime*. Newyork: Dryden; Sutherland, E., H., (1944) 'Is White Collar Crime, Crime?' 10 (2) *American Sociological Review* 39-132

<sup>181</sup> Pontell, Ibid. 762

<sup>182</sup> Ibid

<sup>183</sup> Ibid

<sup>184</sup> Ibid 762

<sup>185</sup> Ibid; Mayer, M. 1990 *The Greatest Ever Bank Robbery: The Collapse of the Savings and Loans Industry* Newyork: Charles Scribner's Sons; Pizzo, S., Fricker, M., Muolo, P., 1989 *Inside Job: The Collapse of America's Savings and Loans*. Newyork: McGraw Hill.

<sup>186</sup> Pontell Ibid, 762

opportunists to get control and soon, the regulatory and business environment became ideal for control fraud as owners became desperate to sell and opportunists desperate to buy.<sup>187</sup> Black further added that lack of adequate regulation leads to abusive accounting and companies with bad accounting practices tend to grow faster as they are run with fictitious profits, causing investors and creditors to provide even more money for the perpetration of control fraud.<sup>188</sup>

Two notable policy changes were believed to have led to the crisis. This includes the increase in deposit insurance and the deregulation of the thrift industry in the early 1980's which created an environment conducive for the perpetration of fraud. The governmental research particularly pointed out that the change in regulation increased the opportunities for fraud while decreasing the risk associated with the fraud.<sup>189</sup> The research also revealed that about 91% of the hundreds of prosecuted cases was convicted, of which 78% were sentenced to prison, although the sentences were short when compared with other federal offences.<sup>190</sup> It is important to say that despite the large amount of prosecuted cases, a significant amount of cases were left unprosecuted due to inadequate enforcement capacity.<sup>191</sup> According to Rosoff et al, the official statistics of financial loss in the Savings and loans industry that were attributed to white-collar crimes only represent a 'tip of the iceberg'.<sup>192</sup>

Notably, the study revealed that the lack of attention given to large amount deposits or large investments by insiders in the organisation provides an avenue for the continued perpetration of control fraud which according to

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<sup>187</sup> Black Ibid, 7

<sup>188</sup> Ibid

<sup>189</sup> Ibid 757

<sup>190</sup> Ibid 758

<sup>191</sup> Ibid

<sup>192</sup> Rosoff, S.M., Pontell, H.N., Tillman, R. (2002) *Profit Without Honour: White-Collar Crime and the Looting of America*, 2<sup>nd</sup> ed. New Jersey: Prentice Hall, Upper Saddle River, p.279

Wheeler and Rothman was used as a ‘tool and weapon’ for the perpetration of their crimes.<sup>193</sup>

### **2.11.2 Enron**

The Enron scandal is one of the most notorious financial scandals, not only America but across the world, it is therefore important to examine the facts of the case.

Enron was formed in 1985 due to a merger between Houston Natural Gas and Omaha-based Inter North. The CEO of Houston Natural Gas, Kenneth Lay became the CEO of Enron and the company became an energy trader and supplier.<sup>194</sup> Subsequently Enron applied for government deregulation and was granted. By virtue of this, governmental involvement in the company was substantially reduced, therefore creating avenue for series of misconducts including granting executives agency rights over financial reports presented to investors.<sup>195</sup>

Due to this agency rights, Enron’s financial statements could be easily falsified to reflect unearned profits in anticipation of future investments. Through creative accounting, the company was able to misrepresent their true financial status and enjoyed investments from people who not privy to the real state of affairs.<sup>196</sup> They also created subsidiaries known as Special Purpose Entities (SPEs) that were carrying out risky businesses to which disclosure was restricted to partnership investors which subsequently led to

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<sup>193</sup> Wheeler, S., Rothman, M.L., 1982 ‘The Organisation as weapon in White Collar Crime’. 80(7) *Michigan Law Review* 1403-1426

<sup>194</sup> Bratton, W. W. (2001). Enron and the dark side of shareholder value. 76 *Tul. L. Rev.*, 1275.

<sup>195</sup> Ibid

<sup>196</sup> These are accounting practices that utilise gaps in regulation to falsify financial statements of the company. Creative accounting can also be used as a form of earnings management to conceal company debts. Jones, M. J. (2011). *Creative accounting, fraud and international accounting scandals*. John Wiley & Sons, Chichester

huge financial loses.<sup>197</sup> Enron had engaged in some self dealing transactions through its chief finance officer,<sup>198</sup> Andrew Fastow, who had entered limited partnership deals which he became manager of the general partner. By so doing, he earned around \$30 million, the result of which created a continuous accounting manipulation for over four years or around \$1.1 billion.<sup>199</sup> Its dealings with Chewco Investment LP set the pace for later dealings with its LJM partnerships.<sup>200</sup> Overtime, he used Chewco and LJM to buy Enron's poor stocks and shares in the stock market, thereby bolster Enron's financial statements.<sup>201</sup>

The collaborative embezzlement of funds continued for a long period of time with inflated accounts reported at the end of every financial year, leading to more investments from both current and new stockholders.<sup>202</sup>

By August 2000, Enron stock price peaked to about \$90 per share and it became the seventh largest firm in America by market capitalization and for five consecutive years, it was awarded the most innovative firm by fortune magazine.<sup>203</sup>

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<sup>197</sup> Bratton Ibid at 1277. Issues regarding whether or not special disclosure should be made to SPE partnership investors only and not company shareholders have been a subject of debate under Securities law. Experts condemned Enron's special disclosure mechanism as: 'Rotten, Horrible, Indefensible and Shocking' and state that SPE investors should not be given preference over other investors in the market place. See Diana B. Henriques & Kurt Eichenwald, A Fog Over Enron, and the Legal Landscape, N.Y. TIMES, Jan. 27, 2002. Available at <http://www.nytimes.com/2002/01/27/business/a-fog-over-enron-and-the-legal-landscape.html> Last accessed 14.09.15

<sup>198</sup> Hereinafter called CFO

<sup>199</sup> Powers, W.C.Jr., Troubh, R.,S., Winokur, H.,S.,Jr: Report of Investigation by the Special Investigative Committee of the Board of Directors of ENRON CORP. (2002), (Hereinafter called Powers Report) t Available at <http://picker.uchicago.edu/Enron/PowersReport%282-2-02%29.pdf> last accessed 12.09.15

<sup>200</sup> Fastow formed LJM (Lea, Jeffery and Matthew), a company named after his wife and children, in 1999. Fastow set up Chewco as Enron's finance group which he used to keep significant investment partnerships such as LJM from Enron's consolidated investments. (See Powers et al Ibid, Bratton Ibid)

<sup>201</sup> Bratton at 1305-1307, Powers et al Ibid

<sup>202</sup> For a figurative analysis of Enron's Scandal see Powers et al Ibid

<sup>203</sup> Bratton Ibid at1276

However, by December 2011, the company also became number one as the largest bankruptcy claim in American history with shares that had fallen to around 60 cents per share.<sup>204</sup> Due to financial mismanagement by the company's executives, Enron filed for bankruptcy in 2001. The total amount of loss by investors exceeded \$70 billion.<sup>205</sup> Enron became notorious as history's biggest financial fraud and audit failure. This is no doubt a control fraud skilfully carried out by the executives of the company. The most losses were recorded by stockholders and employees, particularly employees who are also shareholders in the company owing to mismanagement of invested funds, stock options, pension funds and savings plans.<sup>206</sup>

As one of the biggest financial scandals in the world, Enron became the subject of debate for regulators, academics and law enforcement agencies and issues such as energy deregulation, financial disclosure, accounting regulation, pension schemes, retirement plans, whistle blowing and internal corporate governance system raised concerns.<sup>207</sup> Series of legislations and regulatory responses have since been provided in the wake of the country's biggest corporate scandal.<sup>208</sup>

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<sup>204</sup> Ibid

<sup>205</sup> Ibid

<sup>206</sup> It is important to state that employees lost their 401k plans, a tax pension scheme established under Section 401(k) of the US Internal Revenue Code of 1986 whereby an employer provides (and sometimes matches) retirement contributions which are deducted from the employee's salary before tax. See Bratton Ibid. In the case of Enron, around 4000 workers were laid off during the period of the crisis and their 401k plans which was heavily invested in the company stock at around 60 percent was locked down. (Bratton Ibid)

<sup>207</sup> See Pratap Chatterjee, Enron: Pulling the Plug on the Global Power Broker, CORPWATCH. Available at <http://www.corpwatch.org/article.php?id=1016> Last accessed 12.09.15, Leslie Wayne, Enron, Preaching Deregulation, Worked the Statehouse Circuit, N.Y. TIMES, Feb. 9, 2002, SEC Examines Ties Between Banks and Enron, WALL ST. J., Jan. 15, 2002

<sup>208</sup> This includes the Sarbanes Oxley Act (SOX) of 2002, a regulatory response by the US Congress following the unethical practices of companies such as Enron, Worldcom and Tyco. The Act is particularly famous for increasing professional reporting requirements, ensuring compliance to corporate laws, increasing prison sentence terms for offenders and providing more protection for whistle blowers. (See generally the SOX Act)

It is shocking to see that a company whose corporate governance system was once the envy of the world had been undergoing a system of skilfully concealed prolonged financial mismanagement. Either that, or hidden regulatory defects at the time simply gave way for the perpetration and continuity of the fraud.

It is no news that Enron's corporate governance system would have allowed control fraud to occur. The corporate governance structure of the company encouraged significant risks of immediate shareholder value in a bid to encourage innovation and economize enforcement costs, therefore causing executives to engage in earnings manipulation. Control fraud as a means of maximizing shareholder value using earnings management begins in the form of accounting fraud. Blair describes this as simply using the flexibility of accounting rules to smooth cash flow numbers, and this can be said to be a first step on the road to control fraud.<sup>209</sup> Concealment of vital financial information coupled with accounting malpractices became the order of the day in the wake of shareholder value maximization.

In the last few years leading to its collapse, Enron had indeed lost track of what goods or services it provided to the public and what its core values were. Rather, what is seen was a kind of trading activity which no one could really explain, but in reality turned out to be a high profile accounting fraud aimed at devising a system of growing revenues for the company in order to maintain a high stock price which in turn would mean fat pay cheques for the executives. It had also manipulated its balance sheets to conceal losses and engaged in accounting fraud. It is important to state that the effect of control fraud through accounting manipulation in a bid to maximize shareholder value also extends to competitive companies who feel pressured

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<sup>209</sup> Blair, M. M. (2003). 'Shareholder value, corporate governance and corporate performance: a post-Enron reassessment of the conventional Wisdom.' *CORPORATE GOVERNANCE AND CAPITAL FLOWS IN A GLOBAL ECONOMY*, Peter K. Cornelius and Bruce Kogut, eds., Oxford: Oxford University Press. 62

with the need to engage in high-risk strategies in order to meet investor demands and expectations, and head off the threat of hostile takeover.<sup>210</sup>

### ***2.11.3 Bank of Credit and Commerce International***

The Bank of Credit and Commerce International (BCCI) scandal was one of the UK's biggest fraud cases in the 1990's. The control fraud involved international financial crime between the founder, Agha Hassan Abedi, a Pakistani Financier and Swaleh Naqvi, his assistant. The BCCI was established in Luxembourg in 1972 after capital was sought from the ruler of Abu Dhabi, Sheikh Zayed and the Bank of America.<sup>211</sup> Although the bank had its head office based in Karachi and London, from inception, it comprised of interrelated affiliations with subsidiaries and banks within banks, insider relationships and charitable organisations in around seventy three countries, becoming one of the fastest growing banks of its time.<sup>212</sup> However, it would be later revealed that BCCI had been insolvent from the start with manipulated accounts, inflated profits generated through illegal investments.<sup>213</sup> It was also revealed that Abbas Gokal, who was one of its executives, laundered funds using his Geneva based Gulf Company. It was later revealed that loans over \$1 billion were made to the Gulf Company, an amount which was in fact larger than BCCI's capital base.<sup>214</sup>

Investigations also revealed a prolonged and unparalleled international control fraud which involved a well calculated and systematic bribery of top officials of countries across the world that had dealings with them.

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<sup>210</sup> Schiesel, S. (2002) 'Trying to Catch WorldCom Mirage' *New York Times* (June 30, 2002), Sect. 3, p. 1 where Executives at companies that were competing with world com reported their pressures to the press. In the words of Sprint Executive, William, T. Esrey: 'Our Performance did not quite compare and we were blaming ourselves.'

<sup>211</sup> Passas, N. (1996) 'The Genesis of BCCI Scandal' 23(1) *Journal of Law and Society*, 57-72

<sup>212</sup> Ibid 58

<sup>213</sup> Kerry, J., & Brown, H. The BCCI affair. A Report to the Committee of Foreign Relations United State Senate, 1992. (Also known as Kerry's Report) *Washington DC, US Government Printing Office*.

<sup>214</sup> Kerry's Report Ibid, Passas, N. (Note 135) 58

According to Kerry's Report, both BCCI and BCCI customers were involved in money laundering across Europe, Asia, Africa and America.<sup>215</sup> Further criminality committed by the bank include facilitation of tax evasion, support of terrorism, illegal immigration, illegal purchase of banks and real estate, arms trafficking, etc.<sup>216</sup> By manipulating the corporate environment, regulations, accounts and audits, regulatory policies for the legal movement of capital and goods across countries were easily evaded in the ordinary course of business with no questioning.

Furthermore, the bank, through its executives was able to infiltrate financial markets in some third world countries and in Europe. In order to achieve this, it engaged the services of third parties to purchase banks and hired highly skilled men such as lawyers, accountants and auditors (otherwise known as 'the yes men' ) to protect its activities.<sup>217</sup> It must be mentioned that the bank even had connections with well known politicians across these countries.

As earlier explained, control fraud is theft by deception; the perpetrator at first creates trust and then betrays the same to the detriment of the victim. This was the strategy employed by Abedi whereby he deceived the US regulators with the trust gained by transacting with notable countries such as China, United Arab Emirates, India, Lebanon, Tunisia and Argentina to mention a few.<sup>218</sup>

Overtime, the US market became next in line, to be infiltrated by BCCI. In 1977, the bank developed a scheme to secretly purchase US banks, open branch offices of BCCI across the US and then later merge both banks. Despite regulatory limitations, the scheme became successful in seven states

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<sup>215</sup> Kerry's Report p.4

<sup>216</sup> Ibid

<sup>217</sup> Ibid

<sup>218</sup> Ibid. 5



and also the District of Columbia.<sup>219</sup> The eventual success of BCCI in the US is no doubt linked to its prior success across other countries, which was achieved in collaboration with heads of state of foreign countries as well as top government officials, therefore, it used its outstanding achievements in these countries to win the trust and ultimately deceive the US regulators into acquiring the banks and this continued for a significant amount of time. In a bid to conceal its intentions, the bank further colluded with several heads of states of foreign Emirates by becoming the most important banker in the Middle-East. Furthermore, the bank used reputable US politicians, regulators and legislators to conceal their intentions in the face of suspicion. This includes Clark Clifford, who was former Defence Secretary, Bert Lance, former director of the office of budget and management under President Jimmy Carter, and the likes.<sup>220</sup>

In the periods leading to its closure, suspicions grew regarding fraudulent activities in the bank. BCCI was indicted in 1988 regarding drug money laundering. Kerry's Report revealed that the judicial system erred in its investigation against BCCI. The justice system worked to frustrate efforts of investigators and prosecutors on the case. Notably, a plea agreement was entered in 1990 which prevented BCCI workers from revealing information about BCCI's larger criminal environment, particularly ownership of First American and other banks across the US.<sup>221</sup> The plea agreement functioned to keep BCCI alive and investigations against the bank practically stopped as a result until mid 1991 when William P. Barr became Attorney General. The eventual global closure of BCCI can be attributed to New York District Attorney; Robert Morgenthau who conducted a criminal investigation of BCCI and revealed a chain of events including activities with its England

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<sup>219</sup> Passas N, (1993) 'Structural Sources of International Crime: Policy Lessons from the BCCI Affair' *20 Crim.e Law and Social Change*, 293-309 p.293

<sup>220</sup> Kerry's Report (n.213) 6

<sup>221</sup> Ibid. Kerry's Report further revealed that the justice department essentially mobilised state regulators to keep BCCI running following the plea agreement and key actions regarding BCCI was delayed.

based Auditors, Price Waterhouse regarding ownership of First American. The investigation was also very instrumental in stopping the planned reorganization of BCCI intended to further conceal BCCI's criminality. The reorganisation was to be among the Bank of England, BCCI's auditors, Price Waterhouse and the government of Abu Dhabi. Subsequently, the indictment of BCCI by the New York District Attorney coupled with information from Price Waterhouse became a substantial reason for Bank of England to close BCCI in 1991.<sup>222</sup>

It suffices to conclude that till date, investigations regarding BCCI remain incomplete and US investigators are faced with the fact that documents are being withheld by the British Government as well as the Government of Abu Dhabi. The case of BCCI remains an eye opener to the vulnerability of the world to international financial crime and control fraud in the banking sector that is beyond government parameters.

## **2.12 Summary and Conclusion: Bad corporate governance as a driver of control fraud**

This chapter reviewed literature on control fraud and corporate governance. It can be seen that according to Black, the basis of control fraud is theft by deception. This is the foundation upon which the control fraudsters in the cases examined perpetrated their fraud. They were prominent members of the corporate society, with years of experience in the banking sector. They have established levels of trust with regulators and investors who trust their judgement and believe their actions.

A close examination of the cases revealed above would also lead to the conclusion that corporate governance is a key to both the occurrence and

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<sup>222</sup> The indictment of the District Attorney would have created a global run, but for the timely intervention of the Bank of England, although information regarding BCCI's fraud was withheld from public knowledge by the Bank of England until it eventually closed BCCI.

possible prevention of control fraud. Issues such as regulatory weakness, inadequate supervision and lack of accountability run through the cases discussed above. It is important to mention that provision of adequate regulation in the corporate sector is not only a function of the companies alone but the entire corporate community including regulators and legislators. Effective corporate governance therefore becomes a collective responsibility in the fight against control fraud. A good illustration for example, is the case of BCCI. In 1990, the Bank of England advised Price Waterhouse of poor corporate governance practices in BCCI such as accounting manipulation, financial misrepresentation, high non-performing loans and evidence of fraud. The Bank of England, in response to the information decided to find a way to prevent its collapse, no criminal action was taken against BCCI at the time, neither was any regulatory response provided that could curb insider abuse in the bank, but rather the Bank of England reached an agreement with BCCI, Abu Dhabi and Price Waterhouse whereby Abu Dhabi would guarantee BCCI's losses and in return, the accounts would be certified by Price Waterhouse; the consequence of which will deceive depositors and creditors into believing that the bank was not in any more danger than it already was, and as a result guaranteeing the continuity of the bank. By so doing, the fraud grew even higher as regulators became ineffective.

Furthermore, although corporate governance has received attention in the last few decades and various countries have developed appropriate codes of corporate governance, control fraud yet remains. This suggests that regulation and soft law without participation of all the relevant actors will only serve to increase the risk of future control fraud. The answer, therefore, lies in enforcement. It is important that corporate participants conform to codes and statutes that are consistently applied by regulators and by the

competitive market.<sup>223</sup> Given that the codes in themselves are not enough to enforce effective corporate governance and ultimately reduce control fraud in the banking industry; it becomes imperative for corporate participation to be encouraged.

In Nigeria, it can be said that control frauds cannot be reduced by the mere provision of adequate corporate governance regulation but should be complemented with a variety of enforcement mechanisms and most importantly the engagement of corporate participants which, when combined, could help to prevent future control fraud in Nigerian banks. The role of corporate participants in enforcing corporate governance and ultimately reducing control fraud therefore becomes important and it is the focus of this research to examine this in relation to Nigerian banks.

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<sup>223</sup> Report of the Ad-Hoc Committee on Capital Market on the near collapse of the Nigerian Stock Exchange. P.8. Available at: <http://proshareng.com/news/download.php?item=AdHocCommitteeonCapMktReport19%25200712.pdf> Last accessed 17.12.14

## Chapter 3

### Methodology and Theoretical underpinnings

#### 3.1 Introduction

This chapter examines the methodology and theoretical underpinnings of the research. The chapter begins with the methodology adopted in the research which is the socio-legal methodology. An exploration of this methodology is provided in order to establish the reasons for adopting same for the purposes of the research. This is then followed by the theoretical underpinning to be used for the research, that is, the agency theory. This is particularly necessary as the foundation to which director-shareholder relationships are based. The principle of ownership and control is also examined which is at the core of principal-agent relationships. The chapter aims to lay theoretical foundations upon which the research is based.

Finally, data and sources used in the research are identified; ethical considerations and also limitations regarding data collection are also explained.

#### 3.2 Methodology

The research will adopt a Socio-legal methodology in order to answer the research questions. Socio-legal methodology is an approach to analysing law, legal phenomena and its relationship with the wider society in order to produce findings that were not determined in advance. There will be an analysis of the law to investigate its adequacy or otherwise. Socio-legal methodology seeks to gain insight into a given research problem from the perspective of the local population it involves<sup>224</sup>, in this case, Nigeria. Socio-legal methodology aims to answer the ‘why’ or ‘how’ questions

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<sup>224</sup> *Qualitative Research Methods: A data collector's field guide*. Available at <http://www.fhi.org> last accessed 22<sup>nd</sup> January 2011

through analysis of a number of unstructured information and data. Socio-legal research is usually effective in obtaining culturally specific information. It includes both theoretical and empirical works drawn from a socio-scientific point of view involving critical legal studies directed towards the concerns, theories and informants of external perspectives with the aim of bringing insights that are not available in the context of a purely 'black law' or doctrinal approach.

The purpose of adopting this method is to achieve an expository research which allows for flexibility of researcher to explore the causal link between corporate governance regulations and control fraud and also examine the peculiarity of the problem of a legal phenomenon with the particular people it involves<sup>225</sup>.

Socio-legal methodology has its relevance to the formation of the research questions as well as the purpose and outcome of the research. It is also helpful in the determination of data and sources to be employed. It helps to contribute to the understanding of the field of enquiry, which is control fraud. Furthermore, owing to the fact that control fraud and corruption as a whole is a reflection of a combination of underlying issues not covered only by the lack of effective regulation, the study aims to understand the links between Nigeria's legal, cultural and social arrangements and the facilitation of fraud. In investigating this, the socio-legal approach will be adopted to strategically examine why Nigerian banks are confronted with the major challenge of control fraud; the aim is to determine the relationship between corporate governance regulation in Nigeria and fraud. The methodology will allow for materials to be drawn from fields such as Social Sciences, including Economics and Sociology towards investigating corporate governance and control fraud in Nigeria.

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<sup>225</sup> Abel, R. L., 1980, Redirecting Social Studies of Law, 14(3) *Law and Society Review*, *Contemporary issues in law and social sciences*, 804-829. 805

The last stage of the research on how corporate governance regulation in Nigeria can be improved to prevent future control fraud in banks and would necessarily involve qualitative empirical analysis in order to formulate strategic recommendations directed towards enforcing legal and policy responses in place in a bid to preventing future fraud and promote effective corporate governance in the light of the findings of the research.

Furthermore, although the inadequacy of regulation is a major factor responsible for the banking crisis of 2009, it is worth noting that the success or otherwise of effective regulation depends on a number of factors. These include not only the improvement of the law to provide for adequate monitoring and enforcement mechanisms, but also the facilitation of effective corporate behaviour between corporate participants to whom the law applies and the wider society. This will therefore require perspectives outside the discipline of law such as economics, sociology and politics. The methodological approach will thus allow for the research to draw inferences and make appropriate recommendations peculiar to Nigeria's institutional configurations.

### **3.3 Theoretical Underpinnings**

The research will mainly employ the Agency theory as propounded by Jensen and Meckling<sup>226</sup> in order to examine the relationship between corporate participants, particularly, directors and shareholders.

As Jensen explained:

‘Agency theory involves a contract under which one or more persons (the shareholders) engage another person (the directors) to perform some service on their behalf

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<sup>226</sup> Jensen, M and Meckling, W. (1976) ‘Theory of the Firm: Managerial Behaviour, agency costs, and ownership structure. 3 *Journal of Financial Economics* 305-60

which includes delegating some decision making authority for the agent'.<sup>227</sup>

Jensen and Meckling begin their analysis by examining the economic theory of risk-sharing by Arrow and Wilson<sup>228</sup> whereby corporate risk is shared among individuals or groups. They identified the problem of risk sharing to begin when parties have different attitudes towards risk. If both parties are utility maximizers, there is a good reason to believe that one will not always act in the best interest of the other. As Eisenhardt<sup>229</sup> explained, agency theory is concerned with resolving the problem that could occur when the desires or goals of the principal and agent conflicts, a problem of risk sharing that could arise when the principal and agent have different attitudes towards risk.

Eisenhardt<sup>230</sup> analysed two streams of agency theory developed by Jensen: Positivist and principal-agent. Both share a common unit of relationship between principal and agent but differ in their mathematical rigour, variable and style. While positivist researchers have focused on identifying situations that principal and agent are likely to have conflicting goals, principal-agent researchers are concerned with the general theory of principal-agent relationship that can be applied to employer-employee and other agency relationships<sup>231</sup>. Positivist researchers focus mainly on the special case of principal-agent relationship in large public corporations while principal-

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<sup>227</sup> Bob Tricker, Coporate Governance, Principles and Practices, 2009 Oxford University Press, P. 219

<sup>228</sup> Arrow, K. (1971) *Essays in the theory of risk bearing*. Chicago Markham; Wilson, R. (1968) On the theory of Syndicates *36Econometrica*, 119-32

<sup>229</sup> Eisenhardt K.M. , (1989) Agency Theory, An Assessment and Review, 14(1) *Academy of Management Review*57-74

<sup>230</sup> Ibid

<sup>231</sup> Harris, M and Raviv, A (1978) 'Some results on incentive contracts with application to education and employment, health insurance and law enforcement. *71 American Economic Review*, 275-84



agent researchers have included more testable implications involving logical deduction and mathematical proof<sup>232</sup>.

This study will particularly lend more to the positivist agency theory to investigate friction between directors and shareholders and how controversial practices, mainly boardroom fraud, can be curbed.

The selected agency theory to be adopted by the research allows for the study to critically investigate the relationship between directors and other corporate participants as agents who impose costs on shareholders, depositors and taxpayers (the principals) and to explore the causal link between corporate governance regulations, boardroom fraud and corporate corruption. The agency theory by Jensen and Meckling<sup>233</sup> which was later elaborated by Fama and Jensen is based upon the principle of trust as a foundation for corporate performance whereby trust involves an agreement between parties with asymmetrical access to information.<sup>234</sup> Shareholders therefore 'trust' the directors to be stewards of their funds.

Although corporate governance is replete with a number of theories ranging from agency theory to stewardship theory, stakeholder theory, ethical theory and resource-dependent theory, this research utilises agency theory to the exclusion of others because agency theory can be extended to encompass taxpayers and depositors as principals as explained above. Also, agency theory makes two specific contributions to corporate governance; first is the creation of a monitoring avenue for board of directors. The agency theory is premised on monitoring executive behaviours. From an agency perspective, boards can be used as monitoring devices for shareholder interests.<sup>235</sup> Compensation and reward is therefore based on firm performance whereby

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<sup>232</sup> Eisenhardt, Ibid

<sup>233</sup> Jensen and Meckling (n. 226)

<sup>234</sup> Bob Tricker, Coporate Governance, Principles and Practices, 2009 Oxford University Press, P. 219

<sup>235</sup> Fama, E.F., Jensen, M.C. 1983. 'Separation of ownership and control' 26 *Journal of Law and Economics*, 301-25

boards are rewarded for taking high conceived actions and high risks. The success or otherwise of the firm determines whether or not the behaviour of corporate participants will be consistent with shareholders' interests. For example, behaviours such as golden parachutes, tunnelling, corporate raiding and corporate corruption are less likely when boards are better monitors of shareholders' interests.

The second contribution of Agency theory is what Eisenhardt describes as 'risk implications'.<sup>236</sup> Owing to the uncertainty of the future of every organisation, Agency theory promotes organisational thinking by extending the boundaries of outcome uncertainty to their implications for creating risk. The implication is that outcome uncertainty together with the preferences in ability to undertake risks could influence contractual relationships between principal and agent.<sup>237</sup>

Agency theory is therefore relevant in situations where there is conflict of interests between principals and agents (in this case, shareholders and directors) and where agent opportunism is likely. Agency theory is basically premised on the concept of separation of ownership and control whereby ownership and management are divided between the principal and agent respectively. It thus seems reasonable to adopt agency theory when investigating issues of principal-agent nature

Having said that, it is important to analyse the concept of ownership and control as the foundation to which agency theory is based.

As earlier explained, Jensen and Meckling define agency relationship as a contract whereby one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves

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<sup>236</sup> Eisenhardt K.M. (1989) 'Agency Theory, An Assessment and Review'*Academy of Management Review* 14:57-1464

<sup>237</sup> Ibid

delegating some decision-making authority to the agent.<sup>238</sup> The principals are identified as shareholders while the directors are agents. If both parties to the relationship are utility maximisers, there is good reason to believe that the agent will not always act in the best interests of the principal.<sup>239</sup> They further examined the ownership structure of a corporation, taking into account how equity ownership by managers can be said to combine their interests with that of the shareholders.<sup>240</sup>

According to them, the principal is able to limit divergences from his interest through monitoring costs and the creation of various incentives aimed at limiting future deviant activities of the agent.<sup>241</sup> Monitoring costs are usually undertaken by shareholders up to the point that these do not exceed agency costs they are aiming to control. For example, providing bonding costs (such as advertising costs that results in attracting more external scrutiny to the firm thus reducing agency costs) for the agent to guarantee that he will not harm the principal, and where this happens, ensuring that the principal is compensated. However, more often than not, there will be a discrepancy between the agents' decisions and decisions that would serve to optimize the interest of the principal. This is because it is generally not feasible for either the principal or agent to ensure that the agent will make vital decisions in the interest of the principal at no cost; generally, monitoring and bonding costs are usually incurred.<sup>242</sup>

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<sup>238</sup> Jensen, M and Meckling, W. (n. 226)

<sup>239</sup> Ibid 310. It can be said that agency theory developed within economics and has since served as a foundation for most scholarly research in corporate governance and provided foundation for a more powerful approach to theories of corporate governance. Monks, R.A.G and Nell Minow, N. (2001) *Corporate governance - 2nd ed.* Oxford: Oxford Blackwell Business, Eisenhardt Ibid; Fama, E.F., Jensen, M.C. (n.235) Jensen, M and Meckling, W. (n.226)

<sup>240</sup> Jensen, M and Meckling, W. (n.226)

<sup>241</sup> Ibid 310.

<sup>242</sup> Otherwise known as pecuniary and non-pecuniary costs. Ibid

Agency costs are defined by Jensen and Meckling to include monitoring expenditures incurred by the principal, bonding expenditures incurred by the agent, as well as residual loss.<sup>243</sup>

According to Fama and Jensen, organisations that tend to separate residual risk bearing from decision management are generally complex in nature because valuable information is then diffused among many agents of the organisation, therefore what we have in most complex organisations are diffuse decision control systems of formal decision levels where the decision of lower agents (such as managers) are submitted to higher level agents (such as the board of directors), initially for ratification and later for monitoring.<sup>244</sup> This is because where there are many residual claimants, decision control becomes a costly exercise; hence, the need to separate residual risk from decision control. This would then create problems of agency relationship between residual claimants and decision agents. The separation of decision management and control at all stages in the organisation, the incurring of monitoring costs by the residual risk claimers and the bonding costs incurred by the agents would collectively help to reduce possible agency problems by limiting the power of agents to appropriate the interests of residual claimants.<sup>245</sup>

The need to separate decision control and management would be effective in complex organisations as they would both allow relevant applicable knowledge to be utilised as and when due because they help to control the agency problems that are posed by diffuse residual claims. Furthermore, in decision control systems where multiple-member board of directors tend to ratify and monitor important decisions as well as choosing, rewarding and

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<sup>243</sup> It is important to note that monitoring goes beyond measuring and observing the agents behaviour from time to time, it also includes practical efforts of the principal to 'control' the behaviour of the agent, such as operational rules, policies, and the likes. Residual loss refers to agency costs incurred despite appropriate monitoring. See Jensen and Meckling (n.226) p. 310-311.

<sup>244</sup> Fama, E.F., Jensen, M.C. (n.235)

<sup>245</sup> Jensen and Meckling (226) p. 310

dismissing important decisions that bear little or no share of the cost effects of their decisions, make it difficult for any form of collusion between decision management at the top and control agents.<sup>246</sup> This ultimately facilitates the separation of the management and control of organisations' most crucial decisions.

It is important to mention here that although the role of corporate governance codes, law and regulation is to ensure the accountability of managers to shareholders, this poses a potential danger, because in doing so, or in their possible failure, they create the possibility of control fraud.

### **3.4 Data and Sources**

The research will adopt a combination of legal and non-legal materials to answer the research questions. Primary sources to be adopted include the Companies and Allied Matters Act (CAMA) 1990 (now 2004), the Banks and Other Financial Instruments Act (BOFIA) 1991 (now 2004), the Central Bank of Nigeria (CBN) Act 2007, Investment and Securities Act, 2007, Institute of Chartered Accountants of Nigeria (ICAN) Act, 1965 amongst others.

Secondary sources include Codes, Guidelines, Policy documents and Reports such as the Code of Corporate Governance for Public Companies in Nigeria, 2003, Code of Corporate Governance for Banks and Other Financial Institutions in Nigeria, 2003, Code of Corporate Governance for Banks in Nigeria Post-Consolidation, 2006, CBN Prudential Guidelines for Deposit Money Banks.2010, Criminal Code CAP (77) LFN 1990, Code of Corporate Governance for Banks and Discount Houses in Nigeria and Guidelines for Whistle Blowing in the Nigerian Banking Industry, 2014, Financial Reporting Council (FRC) of Nigeria Exposure Draft Code of Corporate Governance, 2015.

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<sup>246</sup> Ibid

Furthermore, materials such as scholarly Articles and books will be taken from academic fields in the areas of economics, psychology, philosophy and sociology in order to understand the link between Nigerian Corporate Governance Regulations and control fraud.

### **3.5 Limitations of the Research**

This research is limited to available sources including primary and secondary data such as identified above. It is important to state that attempts to gather first hand data and information from government bodies such as SEC, CBN and EFCC proved abortive. This can be attributed to a number of reasons, including the fact that most of the banks in question have either been made insolvent or merged with other banks. Several attempts to gather information were made in 2013 and 2014 and it can be said that poor record keeping in Nigeria coupled by fear of divulging sensitive information became a major challenge of data collection throughout the course of this research.

### **3.6 Ethical Consideration**

During the course of the research, Legal and Policy documents were handled with adequate consideration. All data used were based on appropriate validation.

## **Chapter 4**

### **Control Fraud of CEOs in the Nigerian Banking Sector**

#### **4.1 Introduction**

This chapter explores the activities of the Chief Executive Officers (CEOs) in the banking crisis of 2009. The chapter looks at the involvement of the five banks' CEOs and the aftermath of the crisis. It is important to say that although some of the members of the board were also arrested with the CEOs and charged with fraud, the thesis only focuses on the involvement of the CEOs of the banks.

The limitation of this chapter is due to the unavailability of data regarding the other members of the board charged with them. It is interesting to see that the CEOs' cases received lots of publicity from the press and the Central Bank of Nigeria (CBN) because of their grave involvement in frauds and the members of the boards were used as accomplices. It would have been good to see the outcome of the cases of these members of the board, were they documented.

The chapter concludes that the activities of the CEOs at the time of the crisis could be based on their ability to get away with it for a long time. As earlier revealed in the previous chapter, control frauds have the tendency of manipulating a system to their advantage. The availability of the CBN's discount window was one of the factors that made the control frauds very plausible at the time. It is interesting to know also that the CBN claimed to have been unaware of the frauds and internal manipulations going on at the time. But could the CBN have been afraid to take them on? Did the CBN simply sit back and let the frauds happen due to the connections of the CEOs involved? The chapter suggests that at the time of the crisis in Nigeria, the country was under the influence of the rich and mighty CEOs

that had been involved with politicians and government thus, the CEOs were effectively ‘immune’ to any probe or questions. It is the aim of this chapter to draw more insights on the pernicious effects of the activities of the CEOs in Nigerian banking crisis.

#### **4.2 The legal position of directors**

For the purposes of this study, it is important to examine the role of directors. This is examined by analysing the legal position of directors under Companies and Allied Matters Act (CAMA) followed by discussion of the control frauds of directors during the crisis.

Section 244(1) of CAMA defines directors as persons ‘duly appointed by the company to manage and conduct the affairs of the company’.<sup>247</sup> A director also includes any person on whose instructions directors are accustomed to act.<sup>248</sup> According to Section 283 of the Act:

‘Directors are trustees of the company's moneys, properties and their powers and as such must account for all the moneys over which they exercise control and shall refund any moneys improperly paid away, and shall exercise their powers honestly in the interest of the company and all the shareholders, and not in their own interests.’<sup>249</sup>

The above definition clearly gives directors control of company’s assets but does nothing to prevent them from perpetrating fraud. It is important that directors are aware of the nature of their position as agents of the company and should be made accountable to the assets managed by them.

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<sup>247</sup> CAMA, 2004, s.244(1)

<sup>248</sup> Ibid s. 245. Section 246 provides for appointment of directors.

<sup>249</sup> Ibid s.283(1)



Furthermore, the definition suggests that shareholders' interest should be the underlying responsibility of directors. CAMA fails to include other stakeholders' interest in identifying the legal position of directors and tends to lean towards shareholder primacy as most important in the definition of directors, which is, putting shareholders at the forefront of corporate performance. This position is different in the United Kingdom. The 2006 Companies Act places the overall success of the company at the forefront of directors' duties. Section 172 stresses that directors must have regard to the long-term consequences of their decision and should act fairly between members of the company and in good faith for the benefit of its members as a whole, (including employees, suppliers and customers) and should take into account the impact of the company's operations on the community and environment in order to promote high business standards. Placing shareholder primacy at the centre of directors' duties may be quite overbearing in Nigeria.<sup>250</sup> In the quest to act in good faith, the demand to make shareholders happy while also acting in the best interest of the company seems hard to achieve in Nigeria. Directors may lose sight of what 'the best interests' of the company are in the quest to satisfy shareholders or even themselves which can lead to activities such as share price manipulation, accounting inflation and earnings management.

That notwithstanding, it is important to mention that shareholders do not have the right to interfere with management. This decision was held in the *Automatic Self-Cleansing Filter Syndicate Co Ltd v Cunninghame*<sup>251</sup> where the effect of distinction of powers between board of directors and members in general meeting was illustrated. In this case, the company's Articles vested management powers on directors and the courts refused to order directors to abide by the decision of the shareholders in general meeting requiring them to dispose of company's assets. The court of appeal affirmed

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<sup>250</sup> The issue of Shareholder primacy is discussed further in Chapter Eight

<sup>251</sup> [1906] 2 Ch 34. Also known as the *Cunninghame case*

that directors are not agents of shareholders and are therefore not bound to abide by shareholders' resolutions where the rules provide for different procedures.<sup>252</sup> The courts considered members in general meeting as 'constituting the company'. The courts were also reluctant to regard members as the 'leader' of the company since doing so would create a conflicting situation in cases of disputes between members and directors.<sup>253</sup>

Furthermore, directors' fiduciary duties are provided for in Section 279 of CAMA where it states that directors stand in a fiduciary duty towards the company and shall act in utmost good faith in every transaction.<sup>254</sup> A separate fiduciary duty to shareholders is provided in subsection 2 of Section 279 where it states that a director owes fiduciary duty to the company where he is acting as an agent of the shareholder and where the shareholder is dealing with company securities.<sup>255</sup> It therefore follows that fiduciary duty directly to shareholders should only arise on rare occasions.<sup>256</sup>

The section goes further to state that directors are to act at all times in what they believe is the best interest of the company and in a careful, diligent and skilful manner.<sup>257</sup> This duty of care and skill is further elaborated in Section 282 where it is stated that directors are to act honestly and in good faith in the best interests of the company, and shall exercise reasonable care, diligence and skill which is expected of them. The section also provides that failure to do this will constitute an action for negligence or breach of duty of care.<sup>258</sup> Likewise, each director shall be individually responsible for the

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<sup>252</sup> Ibid

<sup>253</sup> Ibid

<sup>254</sup> CAMA, 2004 s. 279(1)

<sup>255</sup> Ibid s.279(2)

<sup>256</sup> An example is where directors advise on a particular transaction. *Peskin v Anderson* [2001] 1 BCLC 372, [2001] BCC 874, Mummery LJ, CA; *Coleman v Myers* (1977) 2 NZLR 225

<sup>257</sup> CAMA, 2004, s.279(3)

<sup>258</sup> Ibid s. 282(2)

actions of the board in which he takes part and mere absence of boards deliberation, unless justified will not relieve him of such liability.<sup>259</sup>

Conflict of interests is provided for in Section 280 of the Act where directors are prohibited from making secret profits or achieving unnecessary benefits. In effect, the personal interest of a director is not to conflict with any of his legal duties under the Act.<sup>260</sup>

On the issue of enforceability of directors' duties, Section 279(9) provides that any duty imposed on the director shall be enforceable against the director by the company. An interpretation of this would mean that actions can only be brought against directors in the name of the company, for instance in a derivative action and not individually.

It is important to emphasise that the duties of directors across jurisdictions have impacted on corporate governance and indeed control fraud over time. In the case of Nigeria, it can be said that the enforcement of directors' duties has been lacking, therefore creating an avenue for perpetration of fraud. This is due to the ignorant nature of other actors in the web of corporate governance, particularly, shareholders who have left the sole management and running of the company to directors and are more concerned with profit-making.<sup>261</sup>

Going back to the theme of this thesis which is control fraud in Nigerian banks, it is useful to reiterate the position of Black that control frauds are financial super predators who use the company as a vehicle and avenue for perpetration of fraud.<sup>262</sup> Authorised access to assets and properties of the bank provides opportunity for fraud through a breach of trust. This is what

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<sup>259</sup> Ibid s.282(3)

<sup>260</sup> Ibid s.280(1)(a)(b)

<sup>261</sup> The activities of Shareholders during the crisis is discussed in Chapter Eight.

<sup>262</sup> Black, W. K.. (2005) *The Best Way to Rob a Bank is to Own One* Texas: University of Texas Press. Page 1-16

Black calls ‘theft by deception’ whereby the perpetrator creates and then exploits trust to cheat others and erode the trust.<sup>263</sup>

Whether or not directors’ duties may help prevent control fraud cannot be known for certain in Nigeria. This is because control fraud is an institutional problem that is culture specific to the country it applies to and merely strengthening the duties of directors alone may not serve the purpose of preventing future control fraud in Nigerian banks because everyone has a role to play in the web of corporate governance. It suffices to say that the legal provisions in the country as it relates to directors seem to be adequate enough as to potentially prevent or significantly reduce control fraud. However, it is lack of enforcement of these laws that seems to pose the risk of fraud. As would be seen shortly, control frauds as control freaks utilise ongoing legal and regulatory measures as a fraud vehicle and because they are considered to be notable authorities, they can develop a workable system of getting away with control fraud, while still maintaining their dignity. Enforcement therefore becomes necessary for future control frauds to be prevented or reduced in Nigerian banks.

### **4.3 Development of control fraud in Nigeria**

#### ***4.3.1 The banking reforms of 2004***

Banking reforms all around the world have been necessitated by economical and institutional prerogatives. Recapitalization can be said to be a regulatory response to avert a perceived or impending banking crisis. It is important to state that one major factor that can lead to banking crisis is weak corporate governance. This can form the basis for control fraud that can then lead to bank failures. Adegbaju and Olokoyo consider a number of factors that can also trigger banking crisis; these include undercapitalization, insolvency, persistent illiquidity, high level of non-performing loans and weak corporate

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<sup>263</sup> Ibid

governance.<sup>264</sup> Countries with weak financial system can be vulnerable to banking crisis owing to the inability of the bank to meet its financial obligations to stakeholders; the result of which will be a run on banks with depositors withdrawing money in fear that the bank may be insolvent.<sup>265</sup> Mechanisms such as recapitalization, consolidation in terms of mergers and acquisition, use of bridge banks and asset management companies are timely interventions to prevent bank crisis. The role of consolidation is to strengthen the banking system, enhance healthy competition, increase efficiency, and also to strengthen the intermediary role of banks, particularly in overall economic development. Berger argues that increase in the size of banks through consolidation could lead to increase in returns and elimination of weak banks can reduce industry risks.<sup>266</sup>

However, De Nicolo et al argue that bank consolidation increases banks' propensity to risk taking through leverages and off balance sheet transactions and complex entities are also costly to manage.<sup>267</sup> It suffices to say that reforms in the form of recapitalization, consolidation and the likes are determined by the country's economic and developmental needs. In the case of Nigeria, reform is necessary for strong capital base which will become useful where there are non-performing assets. Reform in the form of recapitalization is usually done through consolidation.<sup>268</sup> As Lemo puts it, the reforms are necessary to develop an efficient banking system in the role of financial intermediation and to promote the nations' economic development.<sup>269</sup> It can therefore be said that reforms are a positive step

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<sup>264</sup> Adebajju, A. A. and Olokoyo, F. O. (2008) Recapitalization and Banks' Performance: A Case Study of Nigerian Banks. 6(1) *African Economic and Business Review*, 1-17. 2

<sup>265</sup> Chapter five on the role of regulation sheds more light on bank run

<sup>266</sup> Berger, A. N. (2000). The Integration of the Financial Services Industry: Where Are the Efficiencies? FEDS Paper, No. 2000: 36.

<sup>267</sup> De Nicolo, Gianni, et al. (2003). Bank Consolidation, Internationalization and Conglomeration: Trends and Implications for Financial Risk. IMF Working Paper, 3(158)

<sup>268</sup> Adebajju and Olokoyo (n.264) 3

<sup>269</sup> Lemo, T. 'Regulatory Oversight and Stakeholder Protection' A Paper Presented at the BGL Mergers and Acquisitions Interactive Seminar, held at Eko Hotels & Suites. V. I., on June 24 2005.

towards attaining a diversified and strong financial system in the country with adequate guarantee of depositors' investments. Adegbaju and Olokoyo examine recapitalization as a means of increasing the debt stock of the company either through issuing additional shares with existing shareholders or obtaining new shareholders or both.<sup>270</sup> Apart from consolidation in terms of mergers and acquisitions, recapitalization can also take the form of foreign direct investment.<sup>271</sup> The aim, in the long run, is to increase the capital stock of the bank and to sustain the development of the national economy. However, writers argue that recapitalization may only raise liquidity in short term and may not guarantee the required macroeconomic environment necessary for asset quality and profitability.<sup>272</sup>

The table below summarises the various stages of revolution and reform experienced by Nigerian banks.

**Table 2: The stages of banking reforms in Nigeria**

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<sup>270</sup> Ibid 6.

<sup>271</sup> Ibid

<sup>272</sup> Ibid

1 <sup>st</sup> Reform Era	2 <sup>nd</sup> Reform Era	Third Reform Era	Fourth Reform Era
1929-1951	1952-1971	1982-2004	2004-Date

<p>Over 100 Banks established In the Banking boom between 1940 and 1950</p> <p>Attrition of 30 private banks due to poor management, low capital, debt overhang and the financial shock caused by the 1930's recession</p> <p>British and French Banks established in 1949</p> <p>Agbonmagbe (Wema bank) established in 1945, ACB IN 1948</p>	<p>Enactment of the 1952 Banking Ordinance</p> <p>Establishment of the CBN</p> <p>No. of tradable financial instruments increased in Money market: Treasury bills (1960), Money Fund (1962), Commercial Bills (1968), Treasury Certificates (1968), Certificates of Deposits, Bankers Unit funds and Eligible Loan Stocks (1968)</p> <p>Banking amendment of June 1962 raised minimum share capital to GBP250,000.00</p> <p>Banking Decree No. 1 of February 1969 and the Banking amendment Decree No. 3 of 1970 imposed more stringent conditions in the Industry</p> <p>Industry dominated by government owned banks via Indigenisation Act of 1971</p> <p>Share Capital raised to GBP600,000 (local) and GBP1.5m (foreign)</p> <p>By 1980, there were 26 banks</p>	<p>National Economic Emergency Decree in the wake of financial distress in the 1980's and 1990's (SAP) Era</p> <p>120 Banks (66 Commercial, 24 Merchant)</p> <p>Prudent Guidelines introduced in 1990</p> <p>Bank branches increased from 40 in 1985 to over 2000 in 1992</p> <p>Public Sector accounts transferred from CBN to banks in 1999</p> <p>Universal banking in 2001 with N1bn capital base, which later increased to N2bn with 2004 as deadline</p>	<p>Increase in capitalisation requirements by 1150% to N25 billion</p> <p>No. of banks reduced from 89 to 24</p> <p>Increase in competition leading to Economic growth</p> <p>Total asset rose by 439% to N15trn</p> <p>Nigerian banks accounted for over 65% of stock market capitalisation</p> <p>Global economic crisis and structural lapses in the NSE leads to collapse of the stock market with banks exposed to increased NPL's</p> <p>Sharp turndown in oil prices leading to introduction of unorthodox policies</p> <p>Standard and poor downgrades</p> <p>New CBN governor takes over intending to sanitise the banking system with emphasis on Regulation, Reporting and Risk Management</p> <p>8 CEO's and their respective boards were sacked, CBN injects N420bn (\$2.8bn) into the distressed banks</p>
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Source: Atuche F, CBN Seminar, May 2009.<sup>273</sup>

As seen above, a major reform in the banking industry took place in 2004 and will be examined below.

In 2004, the then CBN governor, Professor Charles Soludo announced a 13-point reform agenda for Nigerian banks.<sup>274</sup> According to him, total banking sector assets were less than 20% of the country's Gross Domestic Product (GDP) and bank loans contributed to about 4% of the country's GDP at the time.<sup>275</sup> Low capitalization therefore made banks more risky and therefore more susceptible to professional misconducts and unethical practices, and ultimately leading to inability to finance the economy. This is because the CBN believed that banks' unethical practices, that is, weak corporate governance practices resulted in low capitalization. It was therefore thought that recapitalization would; among other things result in sound corporate governance in Nigerian banks.

It is important to state that a set of corporate governance rules was put in place in 2006 (the first of its kind in Nigeria) as an aftermath of the reform which banks were encouraged to follow. This is known as the CBN Code for corporate governance for banks and other financial institutions (post consolidation), 2006 which was intended to embrace international standards of corporate governance in Nigerian banks, to promote greater transparency,

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Atuche,F:“The Nigerian Banking System and the Challenges of the Global Economic Crisis ” at 14th CBN Seminar for Finance Correspondence and Business Editors, Makurdi, Benue State, May 19th – 23rd, 2009.

<sup>274</sup> Charles Chukwuma Soludo, ‘Consolidating the Nigerian banking industry to meet the development challenges of the 21st century’ (Special Meeting of the Bankers’ Committee, Abuja, 6 July 2004) P. 3 <http://www.bis.org/review/r040727g.pdf> accessed 20.12.14

<sup>275</sup> Ibid.



disclosure, and also strengthen the functional role of board of directors by eliminating the role of executive chairman.<sup>276</sup>

The reason for this is because according to the CBN, consolidation through mergers and acquisition requires risk management and supervision, and most importantly, new corporate governance standards.<sup>277</sup>

Furthermore, the main objective of the reform is to promote an efficient and sound financial system; this was to be achieved by improving core themes of corporate governance such as checks and balances, accountability of directors, duties and functions of the board, audit committee and shareholders responsibility. It can therefore be said that in effect, the recapitalization exercise was meant ensure effective corporate governance within Nigerian banks.

The 13-point reform agenda by the CBN included the following::

- Minimum capital requirement of N25 Billion (\$200 million at the time) by the end of December 2005
- Adoption of risk-focused and rule-based regulatory framework
- Phased withdrawal of public sector funds from banks
- Consolidation of banks through mergers and acquisitions
- Zero tolerance for weak corporate governance, misconduct and lack of transparency
- Completion of Electronic Financial Analysis Surveillance System (e-Fass)
- Establishment of Asset Management Company
- Promotion of the enforcement of dormant laws
- Revision and update of relevant laws

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<sup>276</sup> Ibid. This code is analysed in the next chapter

<sup>277</sup> Charles Soludo: 'Nigerian Banking Revolution' Public Finance International 20 Nov.2012. Available at: <http://www.publicfinanceinternational.org/news/2012/11/charles-soludo-nigeria%E2%80%99s-banking-revolution> Last assessed 22.11.15

- Establishment of Financial Intelligence Unit and closer collaboration with the Economic and Financial Services Commission (EFCC)

The banking revolution was to be completed within 18 months and involved both foreign and local banks in Nigeria. It was recorded that the policy revolution was the first of its kind in Nigeria.<sup>278</sup> The CBN, through support from the president, senate and house of parliament set up a ‘war room’ with competent professionals such as government officials, accountants and lawyers with the aim of creating an operational structure for the revolution. According to Soludo, the exercise saw the collaboration of corporate agencies of the government such as the Securities and Exchange Commission (SEC), Corporate Affairs Commission (CAC), Federal Inland Revenue Service (FIRS) and National Deposit Insurance Commission (NDIC) in supporting the CBN with the revolution.<sup>279</sup> The entire exercise led to reduction of the 89 banks in Nigeria to 25 banks through mergers and acquisition and 14 banks also had their licenses revoked.<sup>280</sup>

The CBN proudly announced that it was the first time the banking sector experienced a consolidation of such nature without recourse to public treasury and this indicated a new dawn for Nigerian banks.

By the following year, the banking reform seemed a success. In 2007, 14 Nigerian banks were recorded among the top 1000 banks in the world and by 2008, 2 Nigerian banks were among the top 300 in the world. It suffices to say that the banking reform of 2004 was a ‘perfect solution’ in the wake of global corporate governance revolution. Regrettably, as will be seen shortly, the banking revolution was not enough in itself to prevent control fraud in banks and neither did it prevent financial scandals in other companies.

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<sup>278</sup> Ibid

<sup>279</sup> Ibid

<sup>280</sup> Ibid. The number subsequently reduced to 24 due to voluntary merger and acquisition of two of the banks

### 4.3.2 *Cadbury's financial reporting scandal*

In the periods leading up to the Cadbury scandal, Nigeria witnessed notable downfall of major companies and financial institutions, most importantly, the banking sector. The NDIC reported that in 1989, seven banks were distressed; 1990 also witnessed a total of nine; eight in 1991; thirteen in 1992; twenty four in 1993 and four Banks were actually liquidated in 1994<sup>281</sup>; five in 1995 and a shocking number of twenty six banks as at January 16, 1998<sup>282</sup>.

In view of this, on June 15, 2000, a seventeen-member committee was inaugurated by the SEC<sup>283</sup> in collaboration with the CAC<sup>284</sup> headed by Mr Atedo Peterside, the then chairman of Cadbury Nigeria Plc. The aim of the committee included identifying weaknesses in the current corporate governance practices in Nigeria with respect to public companies, examination of practices in other jurisdictions with a view to adopt international best practices in Nigeria, making recommendations on necessary changes to current practices and to examine any other issue relating to corporate governance in Nigeria.<sup>285</sup>

It is worth mentioning that Cadbury Nigeria Plc was a notable contributor to the work of the Committee whose report formed the basis of the Code of Best Practices of Corporate Governance for public listed companies published in 2003. The company's weighty contribution is also attributed to

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<sup>281</sup> Mamman H. and Oluyemi, S.A. (1994) 'Banks Management Issue and Restoring the Health of Nigerian Banks through Improving the Quality of Management/Employees' 4(4) *N.D.I.C. Quarterly* 57.

<sup>282</sup> *NDIC Yearly Report 1999*, Ejiofor, C 'Liquidation Banks in Nigeria.' *Body and Soul Weekend Paper* Vol. 1 No. 9 (31st October 1999) at p. 12 and 13.

<sup>283</sup> SEC is the body responsible for regulating the capital market sector of the country. See Securities and Exchange Commission Decree No. 71 of 1979. SEC repealed the Capital Issues Commission and took effect retrospectively on the 1<sup>st</sup> of April 1978

<sup>284</sup> CAMA, 2004 s.71(a). This is the body responsible for registration and supervision of the formation, incorporation, registration, management and winding up of companies in Nigeria.

<sup>285</sup> See the Preamble to the SEC Code of Corporate Governance for public companies, 2003 (Also known as the SEC Code).

its connection with Sir Adrian Cadbury, the reputable Chairman of Cadbury Schweppes in Nigeria and the Chairman of the Cadbury Commission which published the Corporate Governance Guidelines in the United Kingdom in 1992<sup>286</sup>.

From the above, it is important to therefore examine the scandal of Cadbury Nigeria Plc as one of the notable early cases of control fraud in Nigeria, soon after the establishment of the first corporate governance code in 2003.<sup>287</sup> The Cadbury financial scandal can be said to be the ‘Enron’ of Nigeria. It therefore becomes imperative to examine the facts of the case.

Cadbury Nigeria Plc was incorporated in Nigeria in 1965 as a 100% owned subsidiary of Cadbury Schweppes.<sup>288</sup> The company mainly deals with the manufacture and sale of sugar, gum and beverages in Nigeria. In 1976, the company sold 40% of its shares to Nigerian investors and Cadbury Schweppes owned majority shares of 60%. The company was listed on the Nigerian Stock Exchange with N750,000,000.00 authorised share capital and N500,424,423.00 paid up capital.<sup>289</sup> Over the years, Nigeria grew to become an important marketer for Cadbury Schweppes group and became the second largest marketer within the African region after South Africa; and is (joint) 4<sup>th</sup> largest within Europe.<sup>290</sup> In terms of employees, there has been a massive increase from 50 in 1950 with a yearly turnover of £120,000

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<sup>286</sup> Adeyinka O. F. (2009) ‘Corporate Governance in Nigeria: the Turning Points’ P.16-18 [https://www.ubagroup.com/upload/docs/corporate-governance-the-turni\\_T4XNA\\_20120901020906uy4pxw8ac7.pdf](https://www.ubagroup.com/upload/docs/corporate-governance-the-turni_T4XNA_20120901020906uy4pxw8ac7.pdf) accessed 3rd July 2014

<sup>287</sup> Other scandals include Lever Brothers and Afribank. (The prior scandal of Afribank before the banking crisis of 2009 will be examined subsequently in the course of this thesis)

<sup>288</sup> Oghojafor, B, George O, Owoyemi, O. (2012), Corporate Governance and National Culture are Siamese Twins: The Case of Cadbury (Nigeria) Plc. *3(15) International Journal of Business and Social Science*, 270. 272. Although Cadbury Nigeria Plc was incorporated in 1965, it had come to Nigeria in 1950 to source for cocoa beans and for feasibility studies regarding setting up a market for manufactured goods; and between 1950-1965, it operated as a repackaging company whereby manufactured products were imported from the UK and then resold in smaller packages in Nigeria.

<sup>289</sup> Ibid

<sup>290</sup> Ibid. This is a joint 4<sup>th</sup> position with Ireland in 2007. See also Cadbury Nigeria Handbook, 2007

to 2,429 with yearly turnover of \$200million.<sup>291</sup> In 2003, it was among the top 10 of the 258 quoted companies on the Nigerian Stock Exchange.<sup>292</sup> By the end of January 2006, the company had a net value of £120million with annual profit of £20million.<sup>293</sup>

However, on 16<sup>th</sup> November 2006, upon alleged accounting irregularities, Cadbury Schweppes conducted a preliminary accounting investigation which confirmed a significant amount of financial overstatement that continued for a number of years.<sup>294</sup> The investigation revealed that the financial falsification was a collaborative act by Akintola Williams Deloitte (AWD) and the Managing Director (MD)/CEO, Bunmi Oni and the Finance Director, Ayo Akadiri who were immediately sacked and replaced by expatriates. The company also predicted a loss of around £5 to £10 million in 2006.<sup>295</sup> Cadbury Nigeria Plc was quick to refute these allegations and employed an audit firm, PricewaterhouseCoopers (PwC) to conduct an independent audit of the firm. This then necessitated the involvement of the SEC which launched its own investigations and the issues for determination included inadequate disclosure and non-compliance with Corporate Governance Codes, deteriorating cash flows, declining profitability, worsening leverage flow and obtaining loans for the payment of dividends to shareholders.<sup>296</sup>

On 12<sup>th</sup> December 2006, Cadbury Nigeria Plc issued a statement to the stakeholders of the company, upon investigation by PwC confirming a significant and deliberate overstatement of the company's account over a

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<sup>291</sup> Figures from Cadbury Nigeria Handbook, 2006

<sup>292</sup> Amao, O.O and Amaeshi, K. (2008), 'Galvanising Shareholder Activism: A Prerequisite For Effective Corporate Governance and Accountability in Nigeria,' *Journal of Business Ethics*.1:119-130.128

<sup>293</sup> Ibid

<sup>294</sup> Ibid

<sup>295</sup> Ibid. It is interesting to know that the case became of international interest following the substantial financial involvement of Cadbury Schweppes Overseas Ltd.

<sup>296</sup> SEC Releases Final Decision: <http://www.proshareng.com/article/1495.html> accessed 22.09.13.

period of years which will lead the company to announce a loss of between N1 to N2 billion. In addition, the company will also make exceptional charges of around N13 to N15 billion due to profit and balance sheet overstatements which will significantly impact on the company's reserves.<sup>297</sup>

Consequently, the directors and management were invited for questioning regarding violations of the provisions of the Investments and Securities Act, 1999, the SEC Rules and Regulations 2000 (as amended), the Code of Conduct for Capital Market Operations and their employees as well as the Code of Corporate Governance of Nigeria. The Commissions Administrative Proceedings Committee (APC) was particularly interested in AWD as external auditors involved in two ongoing scandals at the time.

The investigation of the committee, which was concluded in March 2008, revealed a number of findings, especially on the involvement of AWD in the companies involved. Specifically, APC found that:

‘Professional scepticism generally requires that an auditor should not believe documents presented by a client till it sees evidence that they are genuine. In the company’s case, AWD did not probe any further or doubt documents presented by the company in spite of the internal control lapses detected and revealed in the management letters. AWD and in particular the partners that handled the company’s account, did not carry out their assignment with high level of professionalism and diligence expected of a reputable accounting firm of its calibre.’<sup>298</sup>

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<sup>297</sup> Amao, O.O and Amaeshi, K. Ibid, p.128, Oghojafor, B, George O, Owoyemi, O. 273

<sup>298</sup> Ibid

It was also found by the commission that the companies had filed annual report and accounts which contained mis-statements, that the completed audit report of PwC which was submitted to SEC revealed a mis-statement of approximately N13billion for the companies as at September 2006 and both the company directors, auditors and persons in charge of and responsible for the financial documents were liable. Consequently, the MD, Bunmi Oni and the Finance Director, Ayo Akadiri were banned from operating in the Nigerian Capital Market and holding directorship positions in any public company in Nigeria, and their names were passed to the Economic and Financial Crimes Commission (EFCC). AWD was also ordered to pay a fine of N20 million.<sup>299</sup>

It is important to note that in the periods leading to the crisis, the Cadbury scandal was very well pronounced and can be said to have contributed to the commencement of corporate governance regime in line with international standards in Nigeria.

#### **4.4 Control fraud of the five CEOs**

On the 4<sup>th</sup> of June, 2009, a new CBN governor was appointed. The CBN Governor, Mallam Sanusi Lamido Sanusi realised at the time that a total of N256.571billion was outstanding due to the use of the Expanded Discount Window (EDW),<sup>300</sup> majority of which was owed by five banks: Oceanic Bank, Intercontinental Bank, Fin Bank, Afribank and Union Bank. Although the five banks are not the only banks in use of the EDW, it is their persistent

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<sup>299</sup> Ibid

<sup>300</sup> Sanusi Lamido Sanusi 'Address by the Governor of the Central Bank of Nigeria, Mallam Sanusi Lamido Sanusi on Developments on the Banking Sector in Nigeria (Abuja, 14 August, 2009)

<http://www.vanguardngr.com/2009/08/cbn-sacks-5-banks-directors/> accessed 12 October 2011

use that points to a more in-depth problem, which the CBN identified as financial instability due to huge amounts of non-performing loans.<sup>301</sup>

The problem in the said banks certainly had a negative effect on the market due to the problems in their balance sheet and led to a destabilization of the inter-bank market. The CBN had to guarantee the inter-bank market and stopped access to the EDW. By so doing, the CBN could then conduct a thorough investigation of the banks. At the end of their investigation, it was discovered that the banks were struggling to meet their commitments to depositors and were in grave financial difficulty.

Following the investigation, on the 14<sup>th</sup> of August 2009, the Central Bank Governor, fired and replaced the CEOs and Board of Directors of the five banks in accordance with Sections 33 and 35 of the Banks and Other Financial Institutions Act (BOFIA) 1991.<sup>302</sup>

The investigation further revealed that the non-performing loans that were granted by these banks amounted to 39.9 per cent of total loans in the banking sector.<sup>303</sup>

The table below lists the five banks and their respective loans.

**Table 3: Non-performing loans of five distressed banks**

<b>S/N</b>	<b>Bank</b>	<b>Size of Loan (N)</b>
<b>1.</b>	<b>Oceanic Bank Plc</b>	<b>278.2 billion</b>
<b>2.</b>	<b>Intercontinental Bank Plc</b>	<b>210.9 billion</b>
<b>3.</b>	<b>Afri Bank Plc</b>	<b>141.9 billion</b>
<b>4.</b>	<b>Union Bank Plc</b>	<b>73.6 billion</b>
<b>5.</b>	<b>FinBank Plc</b>	<b>42.5 billion</b>

<sup>301</sup> Ibid 3-4

<sup>302</sup> The provisions of these sections will be examined subsequently. The sections empower the governor to intervene in banks in distress.

<sup>303</sup> Ibid 4



<b>Total</b>	<b>747.0 billion</b>
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*Source:* Newswatch, 24 August 2009, *This Day*, 27 August 2009.

The CBN then declared intervention in the distressed banks in order to prevent their collapse by injecting a total of about N400billion (\$1.9billion) in form of Tier 2 Capital which is to be repaid from future capitalization.<sup>304</sup>

In the investigations conducted by the CBN, it was discovered that the CEOs and Board of Directors of the below five banks were allegedly guilty of a number of corporate frauds, particularly in the granting of unsecured loans to both themselves and their friends which later became ‘bad loans’ and mismanaged bank funds with unexplainable transfers and withdrawals from the bank.

The cases that follow explore the control fraud of the CEOs of the top five banks.

#### **4.4.1 Oceanic Bank – Cecilia Ibru**

In 2007, Oceanic Bank International ranked 110 in the list of 200 top African businesses, at number 12 in the West African sub-region and 16 in sub-Saharan Africa.<sup>305</sup> The CEO at the time, Mrs Cecilia Ibru (OFR), a onetime renowned dignitary in the country became the first female CEO to declare over N1billion (\$4.9million), in profit in April 2007.<sup>306</sup>

In 2009, the bank was however, found to be in distress by the CBN and Nigerian Deposit Insurance Corporation (NDIC) due to a wave of fraudulent practices of the CEO. It was discovered that although the maximum limit for

<sup>304</sup> Ibid 6. Tier 2 Capital originates from the Basel Accords. It is a supplementary reserve commonly used by Regulatory agencies such as the CBN to access a financial institutions capital adequacy. It includes subordinated debts, convertible securities and a percentage of loan loss reserves.

<http://www.businessdictionary.com/definition/tier-2-capital.html> accessed 30June 2013.

<sup>305</sup> Otusanya, O. J., Lauwo, S., and Ajibolade, S. O. (2013) ‘An investigation of corporate executive fraud by CEOs in the Nigerian banking sector’ 2(1) *African Journal of Accounting, Auditing and Finance*, 65, 77 (referring to Black Herald, 29 September 2007)

<sup>306</sup> Ibid 77

loans was N1 billion, the CEO had approved loans of over N3billion without prior consultation to the board. Some of which were granted to people whom she was affiliated with, contrary to Section 17(1)(a)(b) and punishable under Section 17(2) of BOFIA.<sup>307</sup> Instances of unaccountable diversion of depositors' funds were also discovered contrary to Section 283(1) of Companies and Allied Matters Act (CAMA).<sup>308</sup>

It was discovered that the former CEO used companies to loot funds belonging to depositors. It was revealed that she acquired over 430 million shares in Oceanic Bank Plc in the name of a company called Africa Lloyd.<sup>309</sup> It was also discovered that in the name of different companies (such as Cloudy Heights, Enifor, Prisky Gold, Bliss Bloss, Velvox and Circular Global Ltd), she acquired over 275 million shares in First Bank Nigeria plc valued at N273,795,139, over 64 million shares in Union Bank of Nigeria valued at N64,218,000; 93 million shares in the United Bank for Africa at N93,750,000 and shares in Oceanic Bank for N1,076,220,421.<sup>310</sup> The CEO had presented manipulated documents to both the CBN and other regulatory agencies contrary to Section 28(1) of the BOFIA which requires that every balance sheet and profit and loss account of the bank shall reveal the true and fair view of the state of affairs of the bank.

It was further discovered that she had bought properties in the USA in the names of her daughter-in-law, Kemi Da Silva, her granddaughter, Janet and her son, Obaroor, and also bought a total of 57 properties in Lagos, Abuja and Port-Harcourt.<sup>311</sup>

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<sup>307</sup> The section provides that no manager shall be directly or indirectly involved in the grant of any loan to any person without declaring such interest and the grant of any loan, advance or credit should be authorised.

<sup>308</sup> The provision involves the legal position of directors particularly as trustees who must account for any money to which they are in control of and must act honestly. It was also discovered that she had moved £1.7billion to the United Kingdom in a transaction which she subsequently transferred to a number of foreign accounts (Ibid)

<sup>309</sup> Otusanya *et al* (n 305) 78

<sup>310</sup> Ibid

<sup>311</sup> Ibid (referring to *The Will*, 3 January 2010, *Zero Tolerance*, 2 October 2010)

On a 25 count charge, the former CEO pleaded guilty and entered a plea bargain, thereby reducing her charges to three and she was sentenced to eighteen months imprisonment for all the three counts. This means six months imprisonment for each of the three counts. However, the jail terms are to run concurrently, which implies that she will only spend six months in prison for the three counts. Justice Dan Abutu in his judgment also ordered that the former CEO forfeit funds worth over N1.2billion in cash and assets.<sup>312</sup> Oceanic bank was subsequently merged with Eco Bank and has since ceased to exist.

The decision of the court is quite surprising, bearing in mind the gravity of the offence. The question that comes to mind would be ‘is six months adequate enough to prevent others from doing the same?’ what is the yardstick for the court’s decision?’ This would also lead to further questions on the judiciary and its independence. As will be seen in the course of this thesis, the judiciary was used as a tool for manipulating justice during in the aftermath of the control fraud. It can therefore be said that the judgment of the court is perhaps a reflection of political influence from the CEO, so that her sentence is mitigated.

Furthermore, after the court judgment ordering Cecilia Ibru to forfeit her assets to the tune of N191billion upon allegations of fraud brought by the CBN through the EFCC, the EFCC is yet to account for the whereabouts of these assets to the investing public, particularly shareholders. Upon a suit filed by the President of the Shareholders Association of Nigeria, Mr Chuks Nwachukwu under the Freedom of Information Act, the court ordered a 72 hour ultimatum for the declaration of both the whereabouts of the assets as

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<sup>312</sup> *BBC News* ‘Former Nigerian Bank CEO, Cecilia Ibru, jailed for Fraud’ *BBC News* (9 October 2010) <http://www.bbc.co.uk/news/world-africa-11506421> accessed 28 October 2012

well as the total amounts spent during prosecution.<sup>313</sup> This order saw the CBN filing an appeal, arguing that disclosing the whereabouts of the assets of Cecilia Ibru would mean disclosing the money it also paid to the lawyers which is confidential information. Nwachukwu, who represented the shareholders, accused the CBN of approving the sale of Oceanic Bank to Ecobank for N25billion where there were assets that could be put to the bank for up to N191billion.<sup>314</sup>

While delivering its ruling, the Appeal court directed that the required information should be provided; noting that none of the information sought threatens national security and compelled the EFCC to abide by the Freedom of Information Act which requires all public institution to disclose information regarding their process and structures.<sup>315</sup>

To date, the CBN refuse to disclose the whereabouts of the assets, and this has raised a number of concerns.<sup>316</sup>

#### ***4.4.2 Intercontinental Bank Plc – Erastus Akingbola***

For two decades, Intercontinental Bank was ranked as one of the country's top five banks; in 2008, it became the only Nigerian financial institution in the top 500 banks in the world according to Financial Times and was widely known across the country for international recognitions and awards.<sup>317</sup>

However, in 2009, following allegations of granting non-performing loans worth N210.9billion, the former Executive Vice Chairman and CEO,

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<sup>313</sup> *ThisDay* 'Justice Ministry, EFCC Flouts Courts Order on Cecilia Ibru's Assets *ThisDay* (26 March 2013, <http://www.thisdaylive.com/articles/justice-ministry-efcc-flout-court-order-on-cecilia-ibrus-assets/143200/> accessed 29 June 2013

<sup>314</sup> *Ibid*

<sup>315</sup> *Ibid*

<sup>316</sup> Freedom of Information Act, 2011, s.12(2). More light is shed on the CBN in subsequent chapters.

<sup>317</sup> Otusanya *et al* (n 305) 79 (Quoting *The News*, 14 September 2009 p.20: 'A grade-A management...the bank is as fit as a fiddle, and its books, the world was made to believe, spick and span...')

Erastus Akingbola, was removed by the CBN as the bank showed distress and liquidity tendencies with the inappropriate use of the EDW and engaging in business activities prejudicial to the interests of its creditors and customers.

According to the CBN:

‘Intercontinental Bank Plc showed signs of a troubled bank with its inability to meet its maturing obligations without persistent recourse to the ‘expanded discount window’ of the CBN and is in dire need of capital...the bank was contravening the BOFIA, especially with regards to maintenance of minimum capital and liquidity ratios, treatment and use of commercial papers and book keeping and accounts reflecting a true and fair view of the financial position of the bank. Worse still, the bank had insufficient assets to cover its liabilities...’<sup>318</sup>

Upon further investigations by the EFCC, it was discovered that despite the financial distress of the bank, the board constantly approved holiday packages worth \$10,000 to its non-executive directors. This was contrary to the Code of Corporate Governance for banks which in fact limits non-executive directors to sitting allowances and surely can be said to be a mechanism devised to bribe and get them on board, using fat pay packages to command subordination. The former CEO was also discovered to have granted loans to customers with accurate financial statements as well as Memorandum and Articles of Association and with less valuable collaterals contrary to Section 17(b) of BOFIA.

The type of control fraud in Intercontinental Bank can be linked to what Black calls ‘The Yes Men’ as explained in the previous chapter. This is a

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<sup>318</sup> Ibid (referring to *TheNews*, 14 September 2009 p.21)

type of fraud where the CEO uses constant praises and monetary benefits to win the necessary people on board. They use their power and influence to ‘bully and bamboozle’ their allies.<sup>319</sup> The approval of excessive pay packages for non-executive directors goes to show the extent to which control frauds will go to conceal their intention. The audited statements of the bank also reflected insider loans worth N26.78billion of which N20billion was non-performing. A total of undisclosed non-performing loan facility of N87.61billion was discovered as a violation of Section 28(1) of the BOFIA.<sup>320</sup>

The EFCC in conclusion of its investigations charged the former CEO for alleged corrupt practices on a 22 count money-laundering charge of tax fraud, theft, criminally granting of loans, share price manipulation, insider trading, reckless consideration of credit facilities, obtaining by false pretence and abuse of office. The EFCC further alleged that the bank engaged in serious economic and financial crimes to the total of N346.19billion. Further analysis discovered illegal transfer of about N10.7billion from Intercontinental Bank to the client account of Fuglers solicitors in London, a group of solicitors unknown to the bank.<sup>321</sup> It was further discovered that the MD had also transferred money illegally to a number of companies of which he was major shareholder. Further investigations conducted by the EFCC revealed that between May and June 2009, a total amount of N8.685billion was looted and transferred from the bank and its subsidiaries to Tropic Finance Limited and other companies in which the CEO, together with his wife, were major shareholders.<sup>322</sup>

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<sup>319</sup> Black, W. K.. (2005) *The Best Way to Rob a Bank is to Own One* Texas: University of Texas Press page 3

<sup>320</sup> Otusanya *et al* (n 305) 79

<sup>321</sup> Otusanya *et al* (n 305) 80 (Referring to *EFCC News*, 25 August 2010)

<sup>322</sup> *Ibid.* These include; Tropic Securities ltd, Tropic Finance and Investment company ltd, Tropic Holdings Ltd and Tropic properties ltd. In which Akingbola and his wife were major shareholders and directors.

The investigation further led to the arrest of seven non-executive directors and members of the board of directors who were also arraigned on an 18 count charge for collusion with the CEO in granting unsecured loans of over N36billion to companies in which they were also directors; and taking \$10,000 holiday packages in contravention of the BOFIA, together with manipulation of the balance sheet to conceal the existence of non-performing loans worth N87.6billion.<sup>323</sup>

The case was commenced in the Nigerian Criminal Court and is awaiting hearing after a plea of not guilty has been entered by the former CEO and all the seven non-executive directors. However, after being sacked by the CBN, the former CEO moved to London where a civil case was commenced against him. In the case of *Access Bank V. Akingbola & Ors*, the former CEO was charged with diverting billions of depositors' funds to purchase properties in the UK and for devising an illegal share buyback scheme.<sup>324</sup> According to Judge Michael Burton of the High Court of Justice, Queens Bench division:

‘I cannot see that, in the light of the findings I have made, the Defendant can be said to have acted, either in relation to the first and second heads of claim, to which alone this issue is directed, “honestly and reasonably” ...Quite apart from being contrary to Nigerian Law, it was simply wrong-headed, and was plainly a substantial contributing factor to the collapse of the bank’<sup>325</sup>

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<sup>323</sup> They were alleged to be guilty of an offence under S.28(1) of the BOFIA 2004, punishable under S. 38(3)(a) of the same Act.

<sup>324</sup> *Access bank V. Akingbola & Ors* [2012] EWHC 2148(Comm). It should be noted that Access bank acquired Intercontinental bank in the bailout after the crisis. <http://www.bailii.org/ew/cases/EWHC/Comm/2012/2148.html> accessed 30.06.13 Upon liquidation, Access bank has now acquired Intercontinental bank.

<sup>325</sup> Ibid

The court ruled that Akingbola was liable for directing the bank to buy back its own shares at a loss of about N145billion (\$902million), diverting monies to companies controlled by him or his family and using Intercontinental funds to buy real estate in the UK. He was therefore ordered to return N165billion looted from bank funds.<sup>326</sup>

The case of Intercontinental Bank is a rather surprising one. In Nigeria, the case was commenced at the criminal court but due to the fact that the CEO had fled to the UK and also because he had purchased some properties there as well which became questionable, a civil case was therefore commenced in the UK. The swift judicial system in the United Kingdom meant that he was tried and found guilty in 2012, three years after the banking crisis.

Upon Akingbola's return to Nigeria, the CBN continued his trial at the criminal court and this went on for three years. In that time, all possible efforts were made to frustrate the case and strings were being pulled by the CEO. It is important to say that the judiciary was being used to frustrate the case. According to the CBN governor, after three years of long trial, the case was established before the court and to the amazement of everybody, just two weeks before a decision was made, the judge was being transferred to the Federal High Court; at the very end of trial!<sup>327</sup> A lot of questions were raised as to the legality or otherwise of the judge's miraculous promotion. This no doubt, raised suspicion regarding the political and judicial influence in the case. To date, the CEO was never found guilty of the allegations against him.

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<sup>326</sup> Ibid

<sup>327</sup> Sanusi Lamido explodes: How vested interests are killing Nigeria. <http://www.premiumtimesng.com/news/153212-sanusi-lamido-explodes-how-vested-interests-are-killing-nigeria.html> accessed 22 December 2014



#### 4.4.3 *FinBank – Okey Nwosu*

Before joining First Atlantic Bank in 2002, Okey Nwosu worked as an engineer with Dowell Schlumberger. He also worked with Arthur Anderson as an accountant. In 1991, Okey Nwosu joined Diamond bank and later became the general manager in 2003, he was made the managing director and chief executive officer of First Atlantic bank. The bank later merged with other banks and was known as FinBank.

Between 2008 and 2009, the CEO; Okey Nwosu was accused of failing to produce a true and fair report of the financial state of the bank to the CBN by incorrectly importing N47.6 billion of commercial papers in its statement of assets and liabilities thereby obtaining credit facilities under the Expanded Discount Window.<sup>328</sup>

The former Managing Director of the bank, Okey Nwosu, was accused by the EFCC of looting N19.2 billion from the bank by recklessly granting unsecured loans worth over N9.3 billion and using a number of companies to secure a total of 612,558,934 shares at FinBank at about N6.1 billion in order to raise the financial value of share prices on the stock market, thereby misleading others to purchase shares in the bank.<sup>329</sup> This is contrary to Rule 105 of the Investment and Securities Act prohibiting activities intended to create false or misleading appearance of active trading. The companies include Eureka Global Venture Ltd, Coast Lake Nig. Ltd, Scannel Investment Ltd, Frebond Real Estate Ltd, Tyco Food Processor Ltd, Busch Machine and Tools Ltd and Ondden Oil and Gas Ltd.<sup>330</sup> The MD was also accused of laundering N33.2 billion from the bank and to have conspired to launder a total of N24.3 billion in collaboration with three other directors of the bank which they allegedly

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<sup>328</sup> The Expanded Discount Window Scheme is examined in detail later in this chapter.

<sup>329</sup> Contrary to Bank and Other Financial Institutions Act, 2004, s.17(1)(b)

<sup>330</sup> Otusanya *et al* (n 305) 79 (referring to *The Sun* 3 December 2009). Market abuse through unlawful share price purchases is discussed subsequently in this chapter

purchased over 20 billion shares in several transactions under the name of various companies valued at N18,188,083,059.35.<sup>331</sup>

In Charge No: ID/115C/2011 between *Okey Nwosu, Dayo Famoroti, Agnes Ebubedike and Danjuma Ocholi V. Federal Republic of Nigeria*, the plaintiffs pleaded not guilty to a 90 count charge against them by the EFCC which included alleged stealing and illegal conversion of N19.2 billion, money-laundering amounting to N100 billion, insider abuse and share manipulation and all of them were granted bail. They then launched an appeal at the Lagos High court requesting that the EFCC quash the charges made against them. This was refused by Justice Lateefa Okunnu of the Lagos High court on 8<sup>th</sup> October 2013 and the plaintiffs launched another appeal at the Court of Appeal. On 21<sup>st</sup> November 2013, in Appeal No: CA/L/601/2011, the Court of Appeal overruled the earlier ruling of the Lagos High Court refusing to quash the charges by the EFCC against the appellants. The effect of this meant that the charges against the appellants were quashed. In fact, the Court of Appeal held that the Lagos High Court had no jurisdiction to entertain the matter in the first instance. The decision is presently under appeal at the Supreme Court of Nigeria.<sup>332</sup>

#### **4.4.4 Union Bank – Bartholomew Ebong**

In the case of Union bank, the former group MD was alleged to have granted unsecured loans worth over N150billion to a number of companies between 2007 and 2008, as well as unsecured credit facilities of over N80billion. The CEO was also accused of financial manipulation towards monthly bank returns to the CBN.

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<sup>331</sup> Ibid (referring to *Daily Trust*, 2, December 2009, *Nigerian Tribune*, 12 May 2010). These are Dayo Famoroti, Danjuma Ocholi and Mrs Ebubedike

<sup>332</sup> Ibid. See also Makanjuola, Y. (2015) *Banking Reform in Nigeria: The Aftermath of the 2009 Banking Crisis* Palgrave Macmillian Press, Chapter 5

Furthermore, the former MD together with its subsidiary (Union Trustees Ltd) and the directors of the bank were alleged to have been involved in share price manipulation and dubiously conniving with stockbrokers Peter Ololo and Falcon Securities Ltd between 2007 and 2009, in order to artificially raise the bank's share price for future public offers.<sup>333</sup>

In an investigation carried out by the CBN and SEC, it was discovered that the bank had obtained credit facilities of N30.477 from foreign institutions between October and November 2007, which it subsequently transferred to Falcon Securities Ltd, who then acquired over 620 million units of Union Bank shares in contravention of Section 105 of the Investment and Security Act (ISA) 2007 with regard to false and misleading trading. Thus the acquisition was funded by Union bank in order to artificially increase Union Bank's share price towards future public offers.

It was also discovered that the bank connived with former executive director, risk management and compliance, Samuel Ayininuola, former managing director of Union Trustees, Henry Onyemem, Managing director of Falcon Ltd, Peter Ololo and other members of the board, in a share buyback scheme which involved illegal purchase of shares. Notably, the MD of Falcon Trustees, through its Peter Ololo traded in Union Bank shares with the intention to artificially inflate the share price in contravention contrary to SEC Rule 109b and pursuant to ISA 2007 which provides that shares should only be repurchased out of share premium account or on accumulated profits of the company which would otherwise be available for dividends and must be reflected on the audited accounts.<sup>334</sup>

The EFCC in its suit sought injunctions and financial penalties due to the violations of the ISA. The former CEO and the board of directors were

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<sup>333</sup> Ibid 82

<sup>334</sup> Ibid. The rule on financial assistance is discussed later in this chapter.

faced with a 28 count charge and they pleaded not guilty to the charges .The case remains pending in court.

#### **4.4.5 Afribank – Sebastian Adigwe**

Sebastian Adigwe’s career began in 1986 in Chase Merchant Bank. The former MD and CEO of Afribank, Sebastian Adigwe was appointed in 2006 given his successful career as a deputy manager in Ecobank.<sup>335</sup>

With regards to Afribank, it was alleged that a total of N91billion worth of unsecured loans was granted by the bank to Falcon Securities Limited, Rehobet Assets Ltd, Kolvey Company Ltd and several other companies.<sup>336</sup> The CEO and board of directors were also alleged to have provided true and fair statements to the CBN from October 2008 - May 2009 and had failed to disclose the actual financial state of the bank contrary to Section 28(1) of BOFIA. The EFCC accused the CEO and a number of individuals connected to the bank, including Peter Ololo of Falcon Securities (a customer of the bank) for allegedly stealing about N87.5 billion from the bank.<sup>337</sup> This includes N15million which was approved in board meeting as a loan by the CEO through his company called Rehoboth Asset Limited. It was believed in the meeting that the money will be used to buy shares in the stock market.<sup>338</sup> The money was however transferred to a company known as AIL Securities Limited through cheques written on 15 September 2008.<sup>339</sup> The same method was also done in October 2008 to transfer another N15 billion into AIL Securities Limited and in 2009, just before the crisis, another sum of N12 billion was transferred under false pretence and

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<sup>335</sup> Ibid. 83

<sup>336</sup> Ibid

<sup>337</sup> It is important to note that Falcon Securities had previously been involved with Union Bank in share buy-back scheme discussed above.

<sup>338</sup> Ibid. See also The nation Newspaper, 21 July 2015

<sup>339</sup> Ibid

using fraudulent documents. Loans were granted with no adequate collateral which subsequently became non-performing.<sup>340</sup>

A 36 count charge brought by the EFCC against Sebastian Adigwe and some members of the board of directors to which they all pleaded not guilty, Sebastian Adigwe pleaded that the Federal High court (presided over by Justice Dan Abutu) should dismiss the alleged charges of corruption against him.<sup>341</sup> The case has been ongoing since and remains pending in court.

It is imperative to mention that the case of Afribank raised concerns by shareholders regarding the sacking of the bank's CEO and ultimate merger of the bank. The role of other bodies such as the CBN and Association of shareholders will be analysed in more detail over the course of this thesis.

#### **4.5 The Big Five: What Went Wrong?**

According to the special investigation that was conducted by the CBN and NDIC:

1. 'Excessive high level of non-performing loans in the five banks which was attributable to poor corporate governance practices, lax credit administration process and non-adherence to the banks' credit risk management practices'.<sup>342</sup>

Total amount of non-performing loans was therefore between 19 – 48%, meaning that the banks will need to provide additional N539.09 billion. Granting of non-performing loans is contrary to Section 20 of BOFIA restricting certain banking activities. Section 20(1) prohibits banks from

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<sup>340</sup> Ibid

<sup>341</sup> Ibid

<sup>342</sup> Sanusi Lamido Sanusi 'Address by the Governor of the Central Bank of Nigeria, Mallam Sanusi Lamido Sanusi on Developments on the Banking Sector in Nigeria (Abuja 14 August 2009) page 3. <http://www.cenbank.org/Out/speeches/2009/Govadd-14-8-09.pdf> accessed 12 October, 2014.

granting any loan, credit facility or financial assistance that is more than twenty percent of shareholders' funds without prior approval of the CBN, and where necessary adequate security must be provided which should be deposited in the bank.<sup>343</sup>

2. 'The total loan portfolio of these five banks was N2,801.92billion. Margin loans amounted to N456.28billion. Exposure to the Oil and Gas Sector was N487.02billion, while aggregate non-performing loans stood at N1,143billion representing 40.81%'.<sup>344</sup>

3. From the above two points, it is quite clear that the five banks had superfluous exposure to both the Capital Market and the Oil and Gas Industry with high risk areas for other banks in the industry.<sup>345</sup>

4. Due to undercapitalization, the CBN will have to inject capital into the banks to enable it meet its minimum capital adequacy ratio of 10%.

5. The five banks had become over dependent on the CBN and inter-bank market and were unable to meet their obligations to depositors without liquidity support from the CBN or inter-bank market.<sup>346</sup>

The CBN also stated that as at the end of July 2009, the total amount of EDW of the five banks was N127.85billion, a value which represented 89.81% of the total industry exposure to the CBN on its discount window and their aggregate inter-bank loan stood at N253.30billion. This means that their liquidity ratio was ranging between 17.655 to 24% when the minimum liquidity ratio stood at 25%.<sup>347</sup>

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<sup>343</sup> Banks and Other Financial Institutions Act, 2004 s.20(1)(2)

<sup>344</sup> Sanusi Lamido Sanusi Ibid 3

<sup>345</sup> Ibid

<sup>346</sup> Ibid 4

<sup>347</sup> Ibid

It is important to mention that the CBN in its address stated that ‘We will not allow any bank to fail. However, we will also ensure that officers of banks and debtors who contribute to bank failures are brought to book to the full extent of the law and that all proceeds of infraction are confiscated where legally possible’.<sup>348</sup> It becomes imperative to analyse how these control frauds were perpetrated in order to explore the gravity of the problem.

#### ***4.5.1 Control Fraud through CBN’s Expanded Discount Window (EDW) Operations***

A closer look at the cases above suggests that the banks fraudulently and persistently took advantage of the EDW which is only meant to be a last resort, tendering inflated records of accounts thereby deceiving the CBN to act. Control fraud through the use of EDW was perpetrated using regulatory weakness as a tool. This is examined below.

As the apex regulatory body, the Central Bank of Nigeria (CBN) is responsible for the administration of the Banks and Other Financial Institutions Act (BOFIA) 2004 and in promoting adequate banking standards in the country and ensuring efficient payment system.

Essentially, the CBN is charged with the ‘issue of legal tender, maintenance of external reserve to safeguard the value of legal tender, promotion of financial stability and sound monetary environment and serving as banker and financial adviser to the government’.<sup>349</sup>

As a regulator, and in performance of its functions under Section 30 of the CBN Act 2007 regarding liquidity management, the CBN, notwithstanding

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<sup>348</sup> Ibid 7

<sup>349</sup> CBN Supervisory function: <http://www.cenbank.org/Supervision/> accessed 22 June 2013

its recognition of Open Market Operations<sup>350</sup> has in place a Discount Window operation, which applies to Deposit Money Banks and Discount Houses. The Discount Window is to serve as a complementary scheme for institutions facing liquidity problems.<sup>351</sup> The Discount Window became the Expanded Discount Window upon Introduction of the CBN Guidelines on the Expanded Discount Window (EDW) in October 2008 in order to allow a more sound process of absorbing more liquidity in the money market. The EDW is to be utilised as a last resort facility and only on a secured basis with adequate collateral.<sup>352</sup> Furthermore, credits by way of outright or advanced borrowing must be secured by eligible instruments.<sup>353</sup>

It is important to mention vital provisions relating to access to the EDW. Paragraph 5 (i) (ii) (iii) of the Expanded Window Guidelines provides that:

‘All DMBs and DHs shall have direct access to the DW. The Bank through its Banking Operations Department shall exercise good judgment and discretion in the administration of the DW in order to ensure that the DW objectives are met. In particular, institutions may be denied access to the DW in the following circumstances:

(i) If the Bank observes an act of undue rate arbitrage in the operations of the institution’s dealings;

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<sup>350</sup> This is a process whereby the CBN buys or sells government bonds in the Open market as a means of enforcing monetary policy in order to manipulate short term interest rate and supply base money in an economy. The CBN recognises Open Market Operations as the primary means of enforcing changes in the overall level of bank reserves and interest rates in the inter-bank market. See CBN Expanded Discount Window Operations <http://www.cenbank.org/OUT/CIRCULARS/BOD/2008/CIRCULAR%20AND%20GUIDELINES%20ON%20THE%20EXPANDED%20DISCOUNT%20WINDOW.PDF> accessed 29<sup>th</sup> June 2013

<sup>351</sup> Ibid 5

<sup>352</sup> Ibid s.4

<sup>353</sup> Ibid s.6. These include Nigerian Treasury Bills, Treasury Certificates, FBN bonds and any other instrument that may be approved by the CBN from time to time.



(ii) If an institution is found to have contravened the provisions of the Bank's monetary and credit policy guidelines;

(iii) If the Bank discovers that the institution is be over-trading or engaged in undue mismatch of its assets and liabilities<sup>354</sup>

Furthermore, Section 28 of BOFIA provides that the financial statements of banks should give a true and fair state of affairs of the bank as at the end of the report period and should comply with necessary requirements that have been issued.<sup>355</sup>

Going by the above provisions, a fraud on the CBN would be a contravention of the CBN statutes, which include the BOFIA and respective Guidelines, carefully conceived to be concealed from the CBN and utilised to fraudulently take advantage of the EDW.

The CEOs involved had failed to give a true and fair report of the state of affairs of the banks to the CBN, producing false accounting records that conceal the financial position of the bank.<sup>356</sup> For instance, the CEOs of FinBank and Intercontinental Bank were alleged to have failed to provide a true and fair report of the state of affairs of the bank to the CBN, leading the CBN to grant credit facilities to them under the EDW. As earlier mentioned, in the case of FinBank, the CEO, Okey Nwosu, was accused of failing to produce a true and fair report of the financial state of the bank to the CBN by incorrectly importing N47.6billion of commercial papers in its statement of assets and liabilities thereby obtaining credit facilities under the EDW. This also contravenes Section 2 of the Annexure to the CBN Guidelines

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<sup>354</sup> 'The Bank' in the Guidelines is used to mean the CBN. (Ibid 5)

<sup>355</sup> Banks and Other Financial Institutions Act, 2004, s28(1) (2)

<sup>356</sup> Ibid, s. 24-29 on provisions on Books and Accounts.

which lays down eligibility criteria to qualify for the EDW, including sound management statutory minimum capital and specified cash reserve.

In the case of Intercontinental Bank, the CBN found that the bank was contravening Section 24-29 of BOFIA with regards to maintenance of minimum capital adequacy and liquidity ratios, treatment and use of commercial papers, and keeping of books of accounts which reflect a true and fair view of the financial position of the bank and the fact that the bank had insufficient assets to cover his liabilities.<sup>357</sup>

The excessive use of the Expanded Discount Window made the banking crisis much worse. Fraud using this means is apparent from its persistence. As enumerated above, According to the CBN, by the end of July 2009, the total outstanding balance on the EDW of the five banks amounted to N127.85billion, where the total access on the window for all the banks was N256.571billion, amounting to 89.81%. The banks therefore were insufficiently illiquid with, having an average liquidity ratio of 24% where the regulatory minimum was 25%.<sup>358</sup> It is however important to stress that although these banks were not the only banks to have taken advantage of the EDW, the problem lay in their frequent and persistent use which no doubt pointed to a bigger problem of financial instability due to non-performing loans. The banks in question were heavily dependent on the discount window.<sup>359</sup> They used the availability of the window to their advantage, flaunting unsecured loans and causing the CBN to continually grant access to them.

The ability of the CEOs to get away with these frauds for so long is not very surprising considering the calibre of people involved. However, it suffices to say that the CBN's regulatory weakness might have contributed to the

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<sup>357</sup> Otusanya *et al* (n 305) 79 (referring to *The News*, 14 September 2009 p.21)

<sup>358</sup> Sanusi Lamido Sanusi (n 342) 2

<sup>359</sup> The EDW is examined in more detail in the chapter on CBN.

fraud.<sup>360</sup> This may be due to fear of touching the people involved or simply because they were a part of the fraud, having a share of the money.

Why then did the fraud go undetected? One way of looking at it is through what Black identifies as ‘The Yes Men’.<sup>361</sup> The web of people involved, such as members of the boards and employees could have been afraid to expose these activities in fear that they will lose their share of the money or even their job! It is important to be reminded that the problem started long before the CBN governor (Sanusi) came to power. The problem had commenced even before his predecessor, Charles Soludo came in, and had continued up until Sanusi became the governor.<sup>362</sup>

#### ***4.5.2 Control Fraud through collaborative embezzlement***

Control fraud through collaborative embezzlement involved looting of funds; that is, defrauding the banks by diverting money for personal gain using accounting frauds and schemes that tend to front the legitimacy of the fraud. This calculated form of control fraud is usually done in collaboration with other individuals through reckless granting of unsecured loans contrary to Section 20 of the BOFIA or granting of loans above the statutory limit which would later become non-performing. This seemingly legitimate process involved unlawful diversion of bank funds for direct or indirect personal gain was in fact a contravention of Section 17(c) of the BOFIA which prohibits directors from benefiting from any advance, loan or credit facility from the bank.<sup>363</sup> Furthermore, as the cases revealed, most of the loans were granted to companies directly affiliated with the CEO. The resulting effect of the diversion would mean money-laundering mostly

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<sup>360</sup> The role of the CBN is analysed in detail in chapter 6

<sup>361</sup> See n. 97

<sup>362</sup> It is important to reiterate the fact that Sanusi assumed power in June and immediately launched the special investigation which led to the removal of the CEOs in August. Soludo, his predecessor set up the recapitalization exercise and was responsible for the commencement of Corporate Governance Regulation of Banks in the Country.

<sup>363</sup> Banks and Other Financial Institutions Act, 2004, s.17(c)

through the purchase of properties and assets in a bid to turn ‘bad money’ into ‘good money’.<sup>364</sup>

The type of fraud perpetrated by the directors in Nigerian banks during the crisis can be said to be a collaborative fraud, which included the directors themselves, members of the board of directors and outsiders. This is seen where the fraud is perpetrated using various schemes such as setting up companies in the names of friends or families and using the companies to secure loans with the banks, which will then become non-performing.<sup>365</sup> The effective management and day-to-day running of the company is the responsibility of directors headed by the CEO. Directors are generally charged with the duty of decision-making, although it should be borne in mind that they do have the power and duty to conduct the general management of the company as illustrated in the *Cunninghame Case* above, however, where directors use their legal power of management as a means of fraud, then it becomes a problem for the company, and in the case of Nigeria, the result with the big five was financial crisis owing to a trend of excessive borrowing from the CBN and overuse of the discount window by fronting ‘bad loans’.

The use of power and position is a tool for embezzlement of funds particularly in banks with weak internal corporate governance and also where the CEO is also the chairman of the board of directors, creating duplicity of power. A close look at the five banks analysed above reveals that this was the case for most of the banks whereby the CEOs are placed in combined positions of authority at the same time and frauds in these situations could easily be concealed (CEO duality).<sup>366</sup>

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<sup>364</sup> A good example is Cecilia Ibru who was found to have purchased a number of properties outside the country both in the name of herself and her family using funds wired into her account from the bank.

<sup>365</sup> More details and statistics of these loans have been discussed earlier in the chapter.

<sup>366</sup> Iwu-Egwuonwu R., C. (2011) ‘Behavioural Governance and Corporate Governance quality’ 3(1) *Journal of Economics and International finance*. 7

In the case of the five banks, it was revealed that each of the CEO's looted funds in different forms. For instance, the CEO of Oceanic bank was said to have approved loans worth over N3billion without prior consultation to the board. It was subsequently discovered that she had purchased a vast amount of shares in the name of her families and also using various companies as cover up. This can be said to be a calculated form of control fraud perpetrated in collaboration with other individuals. As seen in the five cases examined above, all the CEOs were charged with other members of the board. Embezzlement of funds remains a very paramount type of fraud perpetration in Nigeria.

For the purpose of analysis, it is important to mention the statement of Sanusi in relation to diversion of funds by the CEOs:

‘There was one chief executive officer that took away from her bank over 200billion naira. Okay that was over a billion dollars. And where was this money taken to? Purchase of property. We recovered from one CEO 200 pieces of real estate in Dubai, real estate in Johannesburg, real estate in Potomac in Washington apart from shares in over 100 companies. And all of those were purchased with depositors’ funds’.<sup>367</sup>

Where directors are in breach of their duties, a number of cover up schemes are being utilised to cover their tracks. This includes hiring of the ‘yes men’ and creating a fraud-friendly corporate environment made up of auditors, accountants and employees that can be manipulated for fraud purposes. It remains to be seen whether these collaborative webs led to complicit or ignorant fraud participation and whether the actions or inactions of the participants can be said to be a contribution to the fraud and this issue is addressed accordingly in their respective chapters.

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<sup>367</sup> Sanusi Lamido explodes: How vested interests are killing Nigeria (n. 327)

### ***4.5.3 Control fraud against the Public***

As will be shown below, during the periods leading to the crisis, unlawful share purchases in the form of share buy-back scheme were devised by the CEOs in order to deceive the public into believing in the future of these banks, thereby investing in them. It was seen that the CEOs approved loans for companies under false pretence, and then used the money to buy back their own shares. This is used to artificially raise the price of their shares and flaunt a liquid and fast growing bank which prospective investors and shareholders are encouraged to buy into. The whole point here is deception under false pretence, a clear contravention of the ISA. This is another major attribute of control fraud as it involves calculation and collaboration. It therefore becomes necessary to examine the legal provision regarding share buy-backs in order to understand the extent of the control fraud.

Prohibition of any form of activities created with the intention of creating false or misleading forms of active trading is provided for in Section 105 of the ISA. The ISA identifies this as ‘False Trading and Market Rigging Transactions.’ Fraud on shareholders as in the case of the five banks took the form of unlawful share purchase whereby the CEOs had indirectly purchased shares in the banks, mostly through other banks. This then led to artificial rise in the market value of the shares, thereby misleading the investing public, including existing and potential investors to invest in the bank.

Section 159 of CAMA defines financial assistance to include ‘a gift, guarantee, security or indemnity, loan or any form of credit and any financial assistance given by a company, the net assets of which are thereby reduced to a material extent, or which has no net assets’.<sup>368</sup> The section goes further to limit cases where it is lawful for financial assistance to be

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<sup>368</sup> Companies and Allied Matters Act, 2004, s. 159 (1)

provided, for instance, where a person is intending to purchase shares in a company and /or liability has been incurred.<sup>369</sup>

Section 160 of the Companies and Allied Matters Act in Nigeria generally prohibits a company from buying back its own shares grants except in certain circumstances which are provided for in Section 160(2) to include when the company is settling or compromising a debt, eliminating fractional sales, fulfilling terms of a non-assignable agreement under employee stock programmes, satisfying the claims of a dissenting shareholder or complying with a court order. However, such repurchases may only be made out of profits that would otherwise have been dividends or proceeds from a fresh issue of shares made for the purpose of the purchase.<sup>370</sup> It suffices to say that a company cannot invest in itself in the form of share buy backs except in the above cases;<sup>371</sup> therefore, if a CEO is party to an unlawful share purchase scheme that results in unlawful expenditure of the banks funds, this is in clear breach of directors' duties under Section 283(1) of CAMA (discussed above).

Furthermore, although the CBN is saddled with the responsibility of ensuring that directors act in accordance with their duties, it is the joint responsibility of all corporate participants to secure this provision and raise concerns if necessary. This is the premise on which this thesis is based; that is, to influence other actors to become aware of the need for a collective enforcement of corporate governance.

In Nigeria, the peculiarities of the country would mean that prohibition of share buyback scheme is well founded. The institutional problem of corruption that has become endemic in the country will lead control fraud to manipulate share buyback schemes to their advantage. As the cases above

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<sup>369</sup> Ibid s. 159 (2)(a)(b)

<sup>370</sup> Ibid s. 161

<sup>371</sup> The SEC also adopted certain rules to guide quoted companies in buying their own shares. See Generally Rule 109 (B) of SEC

revealed, the CEOs were very well into devising means to buy back their own shares, notwithstanding the provisions of the ISA and CAMA to the contrary.

#### **4.6 Who bears the risk?**

Following the financial crisis in Nigeria, the people who suffered the most were the depositors and taxpayers. According to Sanusi, banks do not fail; it is the people who run the banks that cause banks to fail.<sup>372</sup> The impact of bank failure is massive, especially in a country like Nigeria where poverty is apparent and there is a big difference between the ‘haves’ and ‘have nots’. Workers such as civil servants who have saved their pension in the bank for 35-40 years of service have to suffer when banks fail, because all their savings are gone. This may also include monies set aside for children’s education and businesses.

It is impossible to quantify the extent of damage done due to bank failure and losses arising from inability to make ends meet. It suffices to say that some people may have lost their lives from inability to pay for medical bills simply because the money set aside had been lost due to bank failure.

So did these banks fail? According to Sanusi, it is like saying ‘a man whose throat has been slain died, the man did not die; he was killed.’<sup>373</sup> This is the case for Nigeria; the crisis was caused by the fraudulent activities of the CEOs, who murdered the banks, hoping to walk away, leaving millions of poor Nigerians to suffer the loss. The total amount of deposits for the banks saved amounted to N4.4trillion, which came from 8-10 million customers so that the depositors will not lose.<sup>374</sup> It must be mentioned that the CBN and NDIC realised the impact of this crisis especially on the depositors bore the risk to protect their interests and secure their future. The provisions of these

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<sup>372</sup> Sanusi Lamido explodes: How vested interests are killing Nigeria (n. 327)

<sup>373</sup> Ibid

<sup>374</sup> ibid



two regulators with regards to insurance of depositor funds are discussed next.

The Nigerian Banking System is regulated by two institutions, the CBN and the Nigerian Deposit Insurance Commission (NDIC), it is therefore imperative to consider the provisions of the NDIC with respect to depositors.

The NDIC is charged with the responsibility of protecting depositors in the event of bank failures by guaranteeing payment of deposit up to the maximum insured sum (N500,000.00 to a depositor in universal banks and N200,000.00 to a depositor in MFBs and PMIs).<sup>375</sup> Insured deposits include Current Account deposits, Savings Account Deposits, Term or Time Deposits and Foreign Currency Deposits. However, deposits such as inter-bank placements, insider deposits (that is, deposits made by Staff, directors and other connected parties), deposits held as collateral for loans, investments in stocks, bonds, commercial papers, mutual funds, annuities and debentures, as well as federal government treasury bills, bonds and notes are uninsured by the NDIC.<sup>376</sup>

Insured institutions include Deposit Money Banks (DMBs), Micro finance banks (MFBs) and Primary Mortgage Institutions (PMIs).<sup>377</sup> Although the primary responsibility of the NDIC is to protect depositors, the NDIC and CBN to actively take preventive measures to halt the occurrence of insurance incidents, through regulation and supervision of the banking institutions; therefore when a financial institution is at the verge of

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<sup>375</sup> Ibid

<sup>376</sup> NDIC <http://www.ndic.org.ng/frequently-asked-questions.html> accessed 30th June 2013. The NDIC deposit insurance covers each account up to its insurance limit including accrued interests up to its closure.

<sup>377</sup> NDIC Website <http://ndic.gov.ng/> accessed 21<sup>st</sup> June 2013. Financial institutions not covered by the NDIC include: Development Finance Institutions such as Bank of Industry, Federal Mortgage Bank, Nigeria Agricultural, Cooperative and Rural Development Bank and Urban Development Bank, Discount Houses, Finance Companies, Investment Firms, Unit Trusts/Mutual Funds, Insurance Companies, Pension Fund Administrators (PFAs)

experiencing troubles, the NDIC sends out early warning signals through the use of off-site monitoring and assistance in order to restore sound operations to the bank.<sup>378</sup> However, it can be concluded that routine checks and investigations conducted on banks failed to reveal the inherent and recurrent problems prevailing in the Nigerian banking system.

#### **4.7 Summary and Conclusion**

This chapter examined the role of CEOs in Control fraud. It can be said that the majority of bank failures which Nigeria has experienced since the 1990s is a reflection of the country's socio-political and economic disorder in the wake of the endemic nature of corruption and lawlessness.

It must be mentioned that the consolidation exercise and also introduction of corporate governance codes did nothing to stop the crisis; it rather put financial pressure on banks which contributed to control fraud. While laws and policies are relevant, it is important that they are backed up with adequate enforcement strategies.

In Nigeria, Managing Directors, or CEOs as the case may be, are regarded as knowledgeable, particularly in the management of the bank. As an employee of the organisation, the CEO is appointed by the board of directors, normally majority non-executives who empower him with specific managerial duties and responsibilities as delegated to him by the board. Being the head of the executive management, the CEO's training, knowledge, skill and experience becomes vital to his appointment, duties, powers and responsibilities. The possession of adequate skills necessary to identify the existence of opportunity and develop means of exploitation would lead to perpetration of fraud.

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<sup>378</sup> Ibid

The corporate environment is therefore filled with people who are very knowledgeable in the system. They know how to get away with things. The greed and selfishness that hovers in the country means that people can easily be bought and those that prove stubborn can be silenced.

The CEOs have been identified as having two weapons only: money and power.<sup>379</sup> They manipulate people around them, turning them into allies for their fraud. They basically ask two questions according to Sanusi. The first is: ‘How much do you want?’ And if you are not willing to be bribed, they tell you: ‘I’m going to destroy you’.<sup>380</sup> In the corporate world, considerable importance is attached to success with less focus placed on the need to utilise socially acceptable means for such success. The consequent loss and hardship that is imposed on depositors, creditors, shareholders and investors as victims of control fraud could be overwhelming.

The Vested Interests as identified by Sanusi are people who profit from the poverty, underdevelopment and corruption of the country, they are not intelligent people, neither are they smart; else they will not be doing what they do.<sup>381</sup> It is not the inability to reveal control fraud that is the problem, but the courage to actually go ahead and do so taking into consideration the calibre of people involved.

Perhaps a deeper understanding of the depth of ‘vested interests’ will lead one to conclude that Nigeria indeed suffers from an institutional problem of corruption where people care less about the problems of others and are willing to deprive others for their personal advantage.<sup>382</sup> This therefore calls for a more structural approach that tends to focus not only on legal and regulatory responses (as these have not been very helpful so far in preventing control fraud), but also effective enforcement strategies to ensure

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<sup>379</sup> Sanusi Lamido explodes: How vested interests are killing Nigeria (n. 327)

<sup>380</sup> Ibid

<sup>381</sup> Ibid

<sup>382</sup> The problem of vested interest is discussed in detail in Chapter Eight.

compliance with corporate governance practices and ethics that will safeguard the banking sector from the control fraud and financial corruption as a whole. However, it must be stressed that enforcement remains a collective responsibility and not the job of any one single corporate participant.

## Chapter 5

### The role of the regulatory framework in the perpetration of control fraud in Nigerian banks

#### 5.1 Introduction

The 2008 credit crunch, which saw major scandals across the world, has raised questions on the credibility of banking regulations across the world.<sup>383</sup> The UK was gripped by the aftermath of the Royal Bank of Scotland Plc affair and, in particular, the remuneration of both its current CEO, Stephen Hester, and the former ‘Sir’ Fred Goodwin (its ‘retired’ CEO). However, this is but one example of the many corporate scandals that have occurred throughout the world.

Likewise, Nigeria has also had its fair share of corporate scandals, particularly in the banking sector with the 2009 scandal, which nearly saw the collapse of the Nigerian Stock Exchange.<sup>384</sup>

In any economy, credibility in financial market regulation is the basis for increased financial investment. The financial system is made up of the money market and the capital market. Whereas the money market provides for prices of funds on a short-term basis, the capital market deals with prices of funds on a long-term basis. Maintaining stability in the financial market is very essential because the market is a reflection of the overall corporate environment of the country. Corporate practices of market operators are therefore important and this is where corporate governance comes in. It is

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<sup>383</sup> Report of the Ad-Hoc Committee on Capital Market on the near collapse of the Nigerian Stock Exchange.  
<http://proshareng.com/news/download.php?item=AdHocCommitteeonCapMktReport19%20200712.pdf> accessed 17 December 2014

<sup>384</sup> Ibid

imperative that markets conform to rules and procedures with due diligence.<sup>385</sup>

In Nigeria, despite the claims that the financial system was immune from the global economic crisis, the Nigerian Stock Exchange, a prominent component of the financial system, was shaken by the end of 2008-2009 financial years and this nearly saw the collapse of not only the stock exchange, but also public companies including banks. The Nigerian Stock Exchange is mainly an equity dominated stock market with market capitalization at the forefront of measuring market depth, stability, liquidity and volume of trade.<sup>386</sup> The collapse of the Nigerian Stock Exchange soon saw the rise of numerous demands for answers by investors and the general public. It remains unclear whether the regulators of the Nigerian Capital Market have been ignorant over the years or whether the country is being caught up by past actions and omissions of a number of regulatory bodies.

Be that as it may, the success of any corporate environment is dependent on the level of compliance to rules, regulations, laws, policies and procedures in place. Simply put, a combination of hard and soft laws. The 2009 banking crisis is a good example of non-compliance with corporate governance regulations in Nigeria. Corporate governance regulations include a combination of hard laws, soft laws and corporate practice.

In view of the above, it is the aim of this chapter to examine the totality of Corporate Governance Regulations in Nigeria. The chapter begins by examining the pre-crisis era of corporate governance and analyses company law and corporate governance codes in place in order to emphasize regulatory inadequacies that led to the crisis. This will be followed by a discussion of the corporate governance regulations post-crisis and whether improvements have been made that could prevent future control fraud. The

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<sup>385</sup> Ibid 7

<sup>386</sup> Market Capitalization is a combination of outstanding number of shares multiplied by the price per share. Ibid 9

institutional problem of Nigeria is stressed here to indicate that the codes were copied from developed countries without taking into account the specific configurations of Nigeria. Other factors faced by Nigeria's corporate governance regulation will also be discussed including regulatory multiplicity and areas of conflicts within the code will be analysed. The chapter aims to provoke further thoughts on how the regulatory framework can be improved to prevent or reduce the likelihood of future control frauds in Nigerian banks.

## **5.2 The Pre-Crisis Era of Corporate Governance in Nigeria (1990-2009)**

During the period before the banking crisis, the main law governing companies in Nigeria is the Companies and Allied Matters Act, which also governs Nigerian banks. As mentioned above, the Act is to apply to all companies registered in Nigeria. However, Nigerian banks are also governed by the Banks and Other Financial Institutions Act (BOFIA) and are to specifically comply with the provisions of the Act. Both CAMA and BOFIA came into operation in 1990 as a major economic initiative to allow for proper management of companies.

### **5.2.1 *Companies and Allied Matters Act, 1990 (Now 2004)***

The right to form a company is provided for in Section 18 of CAMA where it is stated that: 'any two or more persons may incorporate a company by complying with the requirements of the Act with regards to registration of the company'.

Section 20 lists certain groups of people that are disqualified from forming a company and this includes individuals less than 18 years of age, persons of unsound mind, an un-discharged bankrupt or persons or a corporate body in

liquidation.<sup>387</sup> CAMA also identifies six types of companies which are: public and private companies<sup>388</sup>, companies limited by shares, companies limited by guarantee<sup>389</sup>, unlimited companies<sup>390</sup>, incorporated trustees<sup>391</sup> and unit trusts.

Section 79(1) of CAMA states that once a person has subscribed to the memorandum of association of a company, he is considered to be a member of the company upon registration of their name in the register of members.

Section 81 of CAMA spells out the rights and liabilities associated with membership. This includes the right to attend general meetings, the right to receive notice of meetings and the right to speak and vote on any resolution. Ancillary rights include the right to seek redress against unfair treatment and the right to apply to the court or Corporate Affairs Commission where possible.<sup>392</sup>

CAMA lays a good foundation for companies to observe basic corporate governance principles in a bid to ensure transparency and accountability in the organisation. Companies are generally enjoined to keep accounting records by virtue of Section 331 of the Act. The record is to be made in the prescribed manner and kept accordingly.<sup>393</sup> Failure to do so constitutes an offence for every officer liable.<sup>394</sup>

The Corporate Affairs Commission (CAC) has the power to investigate the affairs of the company through the appointment of inspector(s) on application of members holding not less than one-quarter of shares or as the

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<sup>387</sup> CAMA, 2004, s. 18. It should be noted that by Section 18(2), an individual less than 18 years can be allowed to form a company provided that two other persons not disqualified have subscribed to the memorandum.

<sup>388</sup> Ibid s.22 and 24

<sup>389</sup> Ibid s. 26

<sup>390</sup> Ibid s.25

<sup>391</sup> Ibid s.673-695

<sup>392</sup> Ibid s. 81

<sup>393</sup> Ibid s.331-332

<sup>394</sup> Ibid s. 333(3)



case may be.<sup>395</sup> The commission shall also investigate the affairs of the company where the court orders such investigation due to a number of factors, such as where there is reason to believe that the company's affairs are being or have been conducted to defraud its creditors or in an unfair manner prejudicial to some of its members or where persons concerned with the company's formation have been guilty of fraud or where the company was formed for a fraudulent purpose.<sup>396</sup>

It is the duty of directors to prepare individual financial statements every year and this statement should include the balance sheet as at the last day of the year, the profit and loss account of the company, auditors' reports, directors' reports, notes on accounts, etc.<sup>397</sup> It is to be noted that CAMA fails to provide the form in which the individual financial account should take but according to Section 335, the form and content of the account is to be prescribed by the National Accounting Standards Board and the balance sheet shall give a true and fair view of the state of affairs of the company. In addition to this, directors must also provide a group financial statement, which should reflect the true and fair view of the state of affairs of the company and its subsidiaries. Unlike the individual financial statements, the group financial statement is to be prepared in accordance with the second schedule of the Act.<sup>398</sup>

It is also the duty of directors to lay and deliver up to date financial statements to the company in general meeting not exceeding nine months previous to the date of the meeting and not later than 18 months after the date of incorporation of the company.<sup>399</sup> Furthermore, each year, directors are to deliver with the annual returns of the company, a copy of the balance sheet of the company, together with profit and loss accounts, and notes that

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<sup>395</sup> Ibid s. 314

<sup>396</sup> Ibid s. 315

<sup>397</sup> Ibid s. 334

<sup>398</sup> Ibid s.336-337

<sup>399</sup> Ibid s. 345(1)

were delivered to the company in general meeting.<sup>400</sup> Penalty for non-compliance to the above provision would mean that every director liable shall be guilty of an offence and a fine except if it can be shown that reasonable steps were taken to ensure compliance.<sup>401</sup> Furthermore, shareholders have the right to obtain copies of financial statement, failing which the company and every officer guilty shall be liable for a fine.<sup>402</sup>

It suffices to say that in a control fraud; regulatory compliance is achieved based on falsification of accounts and merely showing records to prove that all is well, to the ignorance of the regulators. This is not to say that the regulators could not have done more to prevent the fraud, but only goes to reveal the extent to which control frauds will go to conceal their activities.

In the periods shortly before the financial crisis, the accounting books and balance sheets of the banks failed to reveal any notable sign of distress. This was the case, not only for Nigerian banks but for also for banks in developed countries such as the UK just before the credit crunch. In Nigeria however, bad loans were used to secure funding at the discount window, fronting no apparent sign of financial problems when the reverse was actually the case. Annual financial statements were manipulated to reveal success and lure investors to invest in the banks. There were also systems developed by the company to buy back its own shares in a bid to deceive the public into investing in the banks. This was particularly the case for Union bank and Intercontinental bank. Mention must be made at this juncture that details of the activities of CEO's fraudulent activities and how they breached legal and regulatory measures for financial disclosure are examined in the chapter on CEOs.

Furthermore, CAMA also provides for appointment of auditors, whereby every company at each annual general meeting shall appoint an auditor or

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<sup>400</sup> Ibid s. 345(3)

<sup>401</sup> Ibid s. 346

<sup>402</sup> Ibid s. 349

auditors to audit the financial statement of the company for the next financial year.<sup>403</sup> Appointment of auditors is a legal requirement, which is to ensure accountability and transparency in the company. The auditors are to make a report, known as auditors' report on the financial statement examined by them and on every balance sheet, profit and loss account laid before the company in a general meeting.<sup>404</sup> In the case of a public company, in addition to this, the auditor shall also make a report to the audit committee set up by the company.<sup>405</sup> The audit committee in question shall consist of equal number of directors and representatives of shareholders of the company.<sup>406</sup>

Every auditor of the company is to have an open access to all the company's accounts, books and such information as they think necessary for the performance of their duties and it shall be the duty of the auditor in preparing their report to carry out necessary investigations that may enable them to form an opinion whether proper accounting records have been kept by the company and whether the balance sheets are in accordance with the accounting records and returns.<sup>407</sup>

It is important to also say that the accounting requirement of CAMA on the appointment and duties of auditors is dealt with in detail in the chapter on auditors. The chapter considers the role of auditors in the banking crisis and whether their actions or inactions as the case may be can be said to be as a result of negligence or compliance in the web of frauds.

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<sup>403</sup> Ibid s. 357

<sup>404</sup> Ibid s. 359. The form which the auditor's report should take is set out in the sixth schedule to the Act.

<sup>405</sup> Ibid s. 359(3)

<sup>406</sup> Subject to a maximum number of six. Ibid s 359(4)

<sup>407</sup> Ibid s. 360

### ***5.2.2 Banks and Other Financial Institutions Act 1991 (Now 2004)***

The Banking and Other Financial Institutions Act (BOFIA) was developed as an Act to regulate banks and other financial institutions in Nigeria.<sup>408</sup> The Act is to complement CAMA and to help promote corporate governance practices across financial institutions. Originally established as a Decree in 1991, BOFIA grants supervision of banks to the CBN subject to the overall supervision of the Minister.<sup>409</sup>

In furtherance of the duty to keep proper books provided by CAMA, BOFIA also provides in Section 25 that every bank shall submit to the CBN not later than 28 days after the last day of each month or such other interval as the CBN may specify, a statement showing: the assets and liabilities of the bank, an analysis of advances and other assets, at its head office and branches in and outside Nigeria in such form as the CBN may specify, from time to time. Furthermore, every bank shall submit such other information, documents, statistics or returns as the CBN may deem necessary for the proper understanding of the statements and must be done within a specified time.<sup>410</sup>

Another provision of BOFIA that gives the CBN power to monitor, supervise and regulate the activities of banks in Nigeria is the appointment of the approved auditor. Thus, every bank shall appoint annually a person approved by the CBN, in this section referred to as “the approved auditor”, whose duties shall be to make to the shareholders a report upon the annual balance sheet and profit and loss account of the bank and every such report shall contain statements to the matters and such other information as may be

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<sup>408</sup> BOFIA, 2004 s.1

<sup>409</sup> Ibid

<sup>410</sup> Ibid s. 25. The section further provides that any bank which fails to comply with any of the requirements of the section is, in respect of each such failure, guilty of an offence and liable to a fine not exceeding N25, 000 for each day during which the offence continues.

prescribed, from time to time, by the CBN.<sup>411</sup> Through this provision, the CBN should be able to monitor the financial activities of banks.

Additionally, by virtue of Section 31 of the Act, the Governor of the CBN is empowered to appoint an officer of the CBN who shall be known as the Director of Banking Supervision or by such other title as the Governor may specify, and who is to carry out supervisory duties in respect of banks and other financial institutions, and also to examine the books and affairs of each bank, with unlimited right of access at all times to the books, accounts and vouchers of banks. He also has the power to require from directors, managers and officers of banks relevant information for the performance of his duties.<sup>412</sup>

The power to remove a manager or officer of a bank in distress is contained in BOFIA. In fact, Section 33(2)(c) of the Act states that ‘if after a special investigation or examination of the books of a bank, it is discovered that the bank cannot execute its functions, the Governor of the CBN has the power to remove the manager or officer of the bank.’ This is one way where the CBN can regulate banks in cases that call for concern, for instance where there is allegation of financial misconduct. Again, if after taking such steps stipulated in section 35 of this Act, such other measures as in the opinion of the CBN may be appropriate circumstance, the state of affairs of the bank concerned does not improve, the CBN may turn over the control and management of such banks to the Nigeria Deposit Insurance Corporation (NDIC) on such terms and conditions as the CBN may stipulate from time to time.<sup>413</sup>

From the above, it can be rightly said that BOFIA clearly contains provisions relating to accountability and financial disclosure particularly for banks. This legal requirement was overlooked by CEOs and according to

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<sup>411</sup> Ibid s. 29.

<sup>412</sup> Ibid s. 31.

<sup>413</sup> See generally BOFIA, 2004 s. 33-36.

the CBN governor at the time, one of the major reasons for the crisis was financial misrepresentation and concealment of banks' financial status due to fear of being caught out. It is also important to say that the CBN has argued that Section 35 of BOFIA is the reason why it sacked the five CEOs and injected money into the banks while replacing the banks with new CEOs. At the time of their sacking, Nigerians were shocked at the fact that the CBN did not publish the results of the special investigation that led to the sacking of the CEOs and challenged the authority of the CBN to do so.

However, what is important to note is that legal powers are granted to the CBN by BOFIA, leading one to believe that there exists adequate legal and regulatory provisions when it comes to corporate governance regulation but what is really missing is enforcement and implementation of the codes in the face of fraud.

### ***5.2.3 SEC Code of Best Practices on Corporate Governance in Nigeria (SEC Code) 2003***

Notwithstanding the above provisions of CAMA and BOFIA, the increasing global concerns for corporate governance across the world gave rise to the need for Nigeria to align with international best practices of corporate governance.

The Enron collapse contributed to the birth of the first corporate governance code in the country, which is the SEC code of 2003. Being the first code to regulate companies in the country, it helped in providing awareness of good corporate governance practices and also in improving the corporate environment of the country, stressing the need to enhance accountability, transparency and corporate discipline.<sup>414</sup> The SEC Code mainly focuses on board of directors and their duties; however, attention is also given to the role of other stakeholders such as shareholders and professional bodies in

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<sup>414</sup> See generally the SEC Code, 2003

order to create awareness of the roles of participating bodies to effective corporate governance.<sup>415</sup> The Code stressed transparency in financial and non-financial reporting, establishment of audit committee made up of at least three non-executive directors and the fact that external auditors should not be involved in business relationships with the company.<sup>416</sup> Notably, the code separated the role of MD and CEO and stresses that no one person should perform both roles.<sup>417</sup>

Furthermore, Shareholders' rights and privileges are also stated in the Code to the effect that the board should ensure that all shareholders should be treated equally, however large or small their shares may be and shareholder activism, whether by institutional shareholders or through shareholder groups is encouraged. Organisations are encouraged to inculcate relevant parts of the Code to their companies so that the Code serves as a model for corporate governance in Nigeria.

On the issue of compliance, it was stated in the SEC Code that although voluntary compliance is generally encouraged; SEC will apply appropriate sanctions as necessary and give consideration to the compliance or otherwise in cases brought before it.<sup>418</sup>

It should be noted however, that the Code lacked enforcement strategies. Its voluntary nature also contributed to its slow implementation and efforts to update the Code were not made till 2008.<sup>419</sup> Furthermore, regardless of the Code, companies still experienced insider abuse and poor disclosure and the subsequent Cadbury scandal in 2006 says more on the inadequacy of the Code to govern public companies in Nigeria

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<sup>415</sup> See the Preface to the SEC Code

<sup>416</sup> SEC Code, 2003 s.8

<sup>417</sup> See generally S. 2 of the Code

<sup>418</sup> Preface to the Code

<sup>419</sup> The 2008 SEC Code is discussed subsequently in this chapter

#### ***5.2.4 Code of Corporate Governance for Banks and Other financial Institutions Post Consolidation (CBN Code), 2006***

Two major factors necessitated the CBN Code of 2006. These include the 2004 banking reform and also the Cadbury financial reporting scandal of 2006. This awakened various debates on the effectiveness of the 2003 Code of Corporate governance and the need to improve corporate governance in Nigeria.

Soon after, the 2006 Code of Corporate Governance of Banks and other Financial Institutions in Nigeria was introduced as a mandatory Code by the CBN intended to apply to all Banks and financial institutions in Nigeria.<sup>420</sup> The CBN referred to an earlier survey by SEC, which revealed that corporate governance was at its rudimentary stage in Nigeria, with only about 40% of companies adhering to corporate governance principles.<sup>421</sup> The Code was to complement the 2003 CBN Code, which applied to all public companies in Nigeria, but unlike the 2003 Code, compliance to the 2006 Code of Corporate Governance for Banks (Post Consolidation) was mandatory.<sup>422</sup> As discussed in the previous chapter, shortly before the 2006 Code, particularly in 2004, Nigeria experienced a recapitalization/consolidation scheme in banks. The recapitalization scheme encouraged bigger banks to enter into merger/acquisition arrangements with smaller banks in consolidation in order to strengthen competition both locally and internationally and most importantly to promote good corporate governance practices.

The 2006 CBN Code was aimed at complementing the existing CBN and SEC Codes. According to Section 1.5 of the Code, Banks are expected to comply with both SEC and CBN Codes. The Code identified major weaknesses of Corporate Governance in Nigerian Banks such as ineffective

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<sup>420</sup> Also known as the CBN Code, 2006

<sup>421</sup> CBN Code, 2006 s.1.3

<sup>422</sup> Ibid s. 1.7



board oversight functions, fraudulent and self-serving practices among members of the board, management and staff, overbearing influence of chairman or MD/CEO, especially in family-controlled banks, weak internal controls, non-compliance with laid-down operation procedures, passive or ignorant shareholders, excessive lending and technical incompetence. In addressing the problems identified above, the Code broadly highlighted a number of principles that promote good governance. These include:

- Establishment of strategic objectives and a set of corporate values, clear lines of accountability and responsibility
- Balance of powers and authority so that no one individual is unfettered with decision-making
- Number of non-executive directors should exceed that of executive directors
- Installation of a committed and focused board of directors that will exercise its oversight functions with high level of independence from management and individual shareholders
- Regular meetings of board of directors, at least four times a year
- Directors should be fully competent in financial matters and experience
- Internal monitoring and enforcement of Code of conduct and ethics for director, management and staff
- Effective and efficient audit committee and board
- Compliance with Rules and Regulations
- Shareholders need to be responsive, responsible and enlightened<sup>423</sup>.

Going to a bit more detail, the Code prohibits executive duality by providing that the responsibilities of the chairman should be clearly separated from that of the managing director and provides that the post of executive vice-chairman is not recognised under the Code and no two family members are

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<sup>423</sup> Ibid s.4

to operate the positions of chairman and managing director at the same time.<sup>424</sup>

Also, the Code stresses that regular training of board members should be budgeted annually by banks and while the number of non-executive directors should exceed that of executive directors, the maximum board size should be 20 and at least 2 non-executive directors should be independent directors appointed by merit and who do not represent any particular shareholder interest and with no special interest in the bank.<sup>425</sup> The Code also provides for the establishment of three committees, namely Risk Management committee, Audit Committee and Credit Committee. The Code provides that each of these committees is important in ensuring transparency, due process and disclosure requirements.<sup>426</sup> Appointment to top management positions are to be based on merit and track records of appointees should be additional eligibility criteria.<sup>427</sup>

A notable shortcoming of the Code lies in the provision relating to shareholders. While the Code provides that shareholders should be enlightened and responsible, no suggestion is given as to the way this should take place and how shareholders can be educated as to their rights and obligations.

Furthermore, on the issue of enforcement, the Code also provided that banks should have a Chief Compliance Officer who should also monitor the implementation of the Code and Section 7.1.4 further provides that external auditors should render reports to the CBN on banks' risk management process, internal controls and level of compliance with regulatory directives. Although internal and external measures are provided in ensuring compliance in the form of the Chief Compliance Officer and External

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<sup>424</sup> Ibid s.5.2

<sup>425</sup> Ibid s. 5.3

<sup>426</sup> Ibid sections 6,7 and 8

<sup>427</sup> Ibid s. 5.5.3

Auditor respectively, the Code fails to provide a regulatory form of monitoring enforcement and compliance by the CBN, despite the fact that the Code is mandatory. Furthermore, the Code provides in Section 6.1.4 that false rendition of accounts to the CBN shall attract a stiff sanction of fine plus suspension of the CEO for six months in the first instance and removal and blacklisting in the second, following which the erring staff would be referred to a professional body for investigation.<sup>428</sup> These compliance provisions seem quite weak because, ironically, the CBN did not provide any measure for monitoring rendition to it. It can be said that the use of fines to ensure compliance is inadequate because mere payment of fine is not enough to prevent control frauds from been perpetrated. What is needed, however, is empowerment of all participants in the web of corporate governance so that each body plays its own role in effective corporate governance.

The issue of enforcement becomes of great concern, especially in a developing country like Nigeria. The nature of the country's corporate environment, which has been polluted with corruption and political influence, remains a hindrance to corporate governance and economic development in the country. It is important to reiterate that the main objective of this thesis is to investigate Nigeria's corporate governance regulation in the wake of the 2009 banking crisis and to assess whether or not regulation can help prevent future control frauds in Nigerian banks. The problem of enforcement is stressed throughout the course of this research. It is an endemic regulatory problem in Nigeria which mere legal provisions cannot seem to solve.

It can therefore be said that the problem of regulatory enforcement in the periods before the crisis opened the way for control frauds that were swept

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<sup>428</sup> CBN Code, 2006 s.6.1.4

under the carpet. Subsequently, lack of adequate regulatory enforcement led to the control frauds of 2009.

### **5.3 The Post-crisis Era of Corporate Governance (2009-to date)**

#### ***5.3.1 Code of Corporate Governance for Public Companies in Nigeria, (SEC Code) 2011***

In 2009, Nigeria witnessed a major banking crisis which nearly saw the collapse of the Nigerian Stock Exchange. It is shocking to see that the 2006 CBN Code did little or nothing to prevent the crisis. What is even more shocking is the fact that most of the problems identified by the Code seem to have reoccurred. This then suggests that the Code must be lacking in form to have failed to prevent further banking crisis at the time.

The reason for the failure of the Code is not farfetched. Banks were able to get away with falsification of accounts while fronting figures that suggested success and implied compliance to the Code. Non-compliance can therefore be said to be the major reason for failure of the Code. It was not until the special investigation of the CBN that it was revealed that banks had indeed failed to comply with the Code. Whether this could have been detected sooner would be a question of regulatory failure. Although the banks were quick to inform the CBN that they complied to adequate standards of corporate governance, the persistent use of Discount Window, while still insisting that the banks were ‘booming’ ought to have led the CBN to investigate these banks from time to time, adequately checking their level of compliance to the Code. Perhaps the result may not have been as disastrous as it was and maybe the impact might have been less considering the amount of money that had to be injected by the CBN to the banks as a bail out mechanism.

In 2008, SEC, in an attempt to revise the 2003 Code, published a draft Code of Corporate Governance for all public companies in Nigeria. Three years

after the draft Code was introduced, it finally became operational in 2011. The Code can be commended for its in-depth provisions. The Code reiterated some of the provisions of the CBN Code of 2006. It took into account the banking crisis and seemed to make recommendations that were thought would best help prevent further crisis in banks.

On the issue of CEO duality, the Code stresses that the Chairman should not be involved in the day-to-day running of the Company as this is vested on the Managing Director and the management team.<sup>429</sup> The main purpose of the separation is to avoid over-concentration of powers in the hands of one individual. The potential problems to be encountered with an all-powerful CEO can only be imagined. In Nigeria, this was practiced for a long time, even up till the period of the banking crisis. This no doubt would pose risks of fraud where the same person holds two separate positions and there are no adequate systems in place for checks and balances. The split role of the Chairman and CEO serves as a means of checks and balances and also help prevent abuse of power. However, it is to be said that the efficacy of separation of these roles have been contended by writers who believe that the benefits of separating these roles cannot be ascertained.<sup>430</sup> While the separation will not be of great concern in countries with two-tier board structure, the reverse is the case for countries with unitary board structure, but even in such countries, it is becoming certain that their Corporate Governance Codes are tending towards prohibiting the same person from performing two roles.<sup>431</sup> In Nigeria, the institutional problem of corruption would lead one to believe that separation of the two roles might go a long way in preventing future control frauds in banks.

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<sup>429</sup> SEC Code, 2011 s. 5.1(a), s.5(d)

<sup>430</sup> Elsayed, K., (2007) 'Does CEO Duality Really Affect Corporate Performance?' 15(6) *Corporate Governance: An International Review* 1203-1214; Carapeto, M. Lasfer, M. Machera, K.. 'Does Duality Destroy Value?' *Cass Business School Research Paper* 2005. <http://ssrn.com/abstract=686707> accessed 24 July 2014

<sup>431</sup> See South Africa: King III Report 2009 s.2.16; Egypt: Guide to Corporate Governance Principles 2006, s. 3(6); Tunisia: Code of Best Practice of Corporate Governance 2008 s. 2.1, France: Corporate Governance Code of Listed Corporations 2008, s. 3.1; Italy: Corporate Governance Code 2011, Art.2, principle 4.

Furthermore, it is important to say that only the 2011 SEC Code has adequate provisions for the responsibilities of the Managing Director/Chief Executive Officer as extensive provisions were lacking in CAMA.<sup>432</sup> The 2011 SEC Code has explicit provisions that clarify the role of the MD/CEO. It recognises the MD as head of management who is knowledgeable in necessary areas required to run the company and together with the senior management, helps to ensure a culture of legal compliance, which should be embraced by all levels of the company.<sup>433</sup>

Apart from the day-to-day running of the company, the duties and responsibilities of the MD/CEO include promoting growth and development in the company and representing the company in its dealings with stakeholders.<sup>434</sup> The Code further provides that both the authority of the MD/CEO as well as their relationship with members of the board should be clearly described in a letter of appointment.<sup>435</sup>

Notably, the 2011 Code provides a definition for Independent Directors. Although the word ‘Independent Directors’ was not used in CAMA, Corporate Governance Principles of International best practices across the world tend to refer to Independent Directors and so does Nigeria’s Corporate Governance Codes. The 2003 SEC Code used the word ‘independent director’ as a synonym to non-executive director<sup>436</sup> and this can be said to be inadequate because whereas it every independent director must be a non-executive director, not every non-executive director is an independent director. Section 5.5 of the SEC Code, 2011 defines an Independent Director as a non-executive director who is not a substantial

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<sup>432</sup> CAMA stipulates that the Board can delegate any of its powers to the Managing Director who is capable of ratifying acts undertaken on behalf of the company without authority (see S.66(2), 64(b)) Furthermore, any acts carried out by any agent of the company on the authority of the Managing Director are deemed to be acts of the company (s.66(1)(a))

<sup>433</sup> SEC Code 2011, s. 5.2 (a-c)

<sup>434</sup> Ibid s. 5.2(d)

<sup>435</sup> Ibid s.5.2.(e)

<sup>436</sup> SEC Code, 2003, s. 5(3), 12(b)

shareholder of the company (that is, one whose shareholding directly or indirectly does not exceed 0.1% of the total paid-up share capital of the company); not a representative of a shareholder and has not been employed as an executive of the company or its subsidiary; not related to anyone who has been employed or served as an executive of the company or its group in the past three years; is not an adviser to the company or group other than the capacity of a director, is not a significant customer to the company, has no contractual relationship with the company and is not or has not been a partner or an executive of the company's audit firm, legal or other consulting firm that have a material association to the company.<sup>437</sup> In effect, an independent director should be free of any relationship which could affect his ability to act as a director and provide independent judgment.

Furthermore, the issue of Shareholders' rights and responsibilities is provided for more extensively in the Code, whereas the 2003 Code provides that shareholders should be responsive, responsible and enlightened; there is no provision as to how this should be achieved. Although CAMA has provisions regarding keeping shareholders informed of the affairs of the company,<sup>438</sup> these provisions can be said to be inadequate in the face of changing demands of corporate governance. To further complement the provisions of CAMA, Section 35.4 of the SEC Code, 2011 recognises the changing face of the Nation's technology and as such it introduces the use of websites and investor-relations portals where shareholders and indeed the general public can access information regarding the company and also notices of annual general meetings can be published.<sup>439</sup>

Still on the issue of shareholders, the Code seems to elaborate more on disclosure and transparency where it provides for a number of reports that

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<sup>437</sup> Ibid s.5.5

<sup>438</sup> CAMA makes provisions for Notices and Reports to be available to Shareholders such as Financial statements, and notice of general meetings (CAMA, 2004 s. 344 and 219(1) )

<sup>439</sup> This is regardless of the provisions of CAMA regarding advertisement of notice in at least two daily news papers and also posting of notices or reports to its members. (CAMA, 2004 s.222)

public companies need to prepare and for same to be sent to their shareholders. This includes a comprehensive annual report that takes into account issues such as risk management, business ethics, compliance with the Codes, Human Resource Management, etc.<sup>440</sup>

Also, the Code is credible as the first Corporate Governance Code in Nigeria to make provisions for sustainability issues such as global warming, climate change, environmental factors, etc. Furthermore, the Code identifies with health related issues affecting individuals and requires companies to have strategies in place aimed at managing the impact of diseases such as Malaria, HIV/AIDS and other related diseases on its employees.<sup>441</sup>

Lastly is the issue of whistle-blowing, which is provided for in the Code. Section 32 provides that companies should have a whistle-blowing policy in place such as hotlines or emails targeted at exposing unethical and illegal practices. The anonymity of whistle-blowing will serve to encourage people to make use of the system when necessary.

Having discussed the advantages of the Code, it is imperative to note the inadequacies of this Code in terms of preventing future control frauds.

First is the issue of enforcement. It remains unclear whether the Code is meant to be 'rules-based' or 'comply or explain'. Perhaps what is needed is a rules-based, legal sanction approach as practiced in the United States with the introduction of the Sarbanes Oxley Act (SOX) of 2002<sup>442</sup>. The Code however also suggests that it is meant to be on a comply or explain basis, therefore making compliance self-regulatory like that of the United Kingdom. It is therefore difficult to ascertain which enforcement mechanism is anticipated in the Code. On the one hand, it seems to suggest

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<sup>440</sup> SEC Code, 2011 s. 34-36

<sup>441</sup> Ibid s. 28, s.39(c)

<sup>442</sup> SOX Act 2002, s.404



that that compliance is voluntary,<sup>443</sup> and on the other hand, it suggests that mandatory is mandatory.<sup>444</sup> It is important to state that non-compliance with corporate governance Codes could have catastrophic consequences, not only for the company but also for its investors and stakeholders.

Furthermore, the Code fails to provide defined role for independent directors. According to the Code, a public company should have at least one independent director.<sup>445</sup> Section 4.3 provides that the board should comprise both executive and non-executive directors of which at least one of them should be an independent director. Bearing in mind that an independent director is a non-executive director who is detached in the company and management so much so as to be independent in character and judgment and his main obligation is to promote the best interests of the company. The role of the independent director is therefore at the forefront of effective corporate governance and prevention of control fraud because he acts with the best interest of the company at heart and is therefore likely to be free and fair.

It is important to also mention that all independent directors are non-executive directors but not all non-executive directors are independent directors. It therefore follows that although a company may have a fair amount of non-executive directors on its board, it may still be lacking in independent directors who will be fair in character and judgment. Best practice will therefore be for the majority of members of the board to be independent non-executive directors so as to ensure an unbiased corporate environment, which may open the door for control frauds to take place. For instance, in the UK, Section B.1.2 of the 2012 UK Code of Corporate Governance provides that: ‘Except for smaller companies, at least half the

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<sup>443</sup> SEC Code, 2011, s. 1.3(a) (b). Notably, s. 1.3(b) provides that shareholders should “encourage” compliance with the Draft Code by their companies. See also s. 34.7 s. 34.14

<sup>444</sup> Ibid s.1.3(d) (e)

<sup>445</sup> Ibid. 4.3, s. 34.4(a)

board, excluding the chairman, should comprise non-executive directors determined by the board to be independent.<sup>446</sup>

There is therefore no gainsaying that the role of independent directors is very important and unless they are substantial in number as to have collective impact most importantly in working together to prevent control fraud, their role may be undermined. The approach adopted in developed countries is that they constitute the majority of the board members.<sup>447</sup> This is to ensure a situation where independent directors can influence board decisions, but in a situation where a public company only has a minimum of one independent director, the ability to influence decisions may be practically impossible. It is therefore right to say that for Nigeria to tackle the institutional problem of fraud which has eaten deep into Nigerian banks, it is important to ensure that independent directors constitute the majority of board members as this is a positive step in the fight to help prevent future control fraud in Nigerian banks.

### **5.3.2 CBN's CEO Tenure Policy**

In the past, appointment of the managing director in Nigeria usually lasted for three years and was renewable by the board. This was done according to their discretion and based on satisfactory performance.<sup>448</sup>

However, following the 2009 banking crisis, the CBN in 2010, stressed the need to improve corporate governance in the banking sector and to avoid

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<sup>446</sup> A smaller company is one that is below the FTSE 350 throughout the year immediately prior to the reporting year. See the Financial Reporting Council: UK Code of Corporate Governance, 2012.

<http://www.slc.co.uk/media/78872/uk-corporate-governance-code-september-2012.pdf>  
accessed 1 July 2014

<sup>447</sup> This is the approach adopted in the UK and USA.

<sup>448</sup> Quite a number of CEOs have enjoyed very long tenures. For instance, Erastus Akingbola who was the CEO of Intercontinental Bank held the position from 1987 to 2008 (a total of 20 years), Cecilia Ibru, the CEO of Oceanic Bank International Plc was in office for 12 years (1997-2008). Although, the longer a CEO stays in office, the more experienced he becomes, there is also the tendency that he will perceive the bank as his, becoming dominant, either positively or negatively to performance.

‘sit-tight’ situations which has led to abuse of the system and subsequent bank failures.<sup>449</sup> The CBN therefore, announced a fixed tenure policy for CEOs which imposed a maximum two-term policy of five years each and was retroactive, and actually stated an exit date for the affected CEOs. The CBN in its prudential guidelines provided that CEOs of banks are only able to serve a maximum tenure of 10 years and all CEOs who would have served for 10 years by 31<sup>st</sup> July, 2010 are to resign by virtue of Section 4 of the Guidelines.<sup>450</sup> Furthermore, any person who has served as CEO for 10 years in a bank cannot be appointed in his former bank or subsidiaries in any capacity until 3 years after expiration of his tenure as CEO.<sup>451</sup>

It is however not surprising that the activities of the CBN’s CEO Tenure policy became a subject of discussion especially when it required that a number of serving CEOs should vacate their office by a certain date, bearing in mind that the last 10 years had seen them as ‘successful’ CEOs who (on the face of it) had caused the banks to acquire both local and international achievements.<sup>452</sup>

Aburime et al. consider major concerns of the CBN’s action.<sup>453</sup> First is in the legality of the policy. Critics believe that there are no explicit provisions in the BOFIA and CBN Acts that enable the enactment of this policy.<sup>454</sup> This is notwithstanding the provision of Section 33(1)(b) of the CBN Act which gives the CBN power to issue Guidelines to any institution under its

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<sup>449</sup> This was announced shortly after the 2009 distress in the banking industry

<sup>450</sup> See generally the CBN Prudential Guidelines, S.4

[http://www.cenbank.org/OUT/2010/PUBLICATIONS/BS/PRUDENTIAL%20GUIDELINES%2030%20JUNE%202010%20FINAL%20%20\\_3\\_.PDF](http://www.cenbank.org/OUT/2010/PUBLICATIONS/BS/PRUDENTIAL%20GUIDELINES%2030%20JUNE%202010%20FINAL%20%20_3_.PDF) accessed 30.06.13

<sup>451</sup> Ibid, 4(d)

<sup>452</sup> By virtue of these provisions, the CEO of United Bank for Africa, Tony Elumelu (who had served a total of 15 years), CEO of Skye Bank, Sola Akinfemiwa (CEO since 2000) and the CEO of Zenith Bank, Jim OVIA (CEO since 1990) were all given an exit date of 31 July 2010.

<sup>453</sup> Aburime, T. U., Gannon, G. L., & Corrado, C. J. (2011). ‘How Long Should Bank CEOs Continue? Evidence from Nigeria.’ (December 9, 2011) at p.38-40

<http://ssrn.com/abstract=1970184> or <http://dx.doi.org/10.2139/ssrn.1970184> accessed 28th August 2013

<sup>454</sup> Ibid 38

supervision and also Section 42(1) of the same Act which charges the CBN with the responsibility of ensuring adequate standards of conduct and management in the system; however, the Act does not grant the CBN outright power to limit the tenure of CEOs in Nigeria. Similarly, although no explicit provisions in both the CBN Act and BOFIA stops the CBN from limiting the tenure of CEOs of Nigerian Banks, it is the interference with a pre-existing lawful employment contract that would have been a solid basis for arguments in favour of compensation to all contracting parties (that is, banks and their CEOs) for the inconveniences they suffered due to this policy.<sup>455</sup>

Secondly, issues regarding performance, quality, tenure and pay are dealt with by the board of directors who have the duty to protect the interest of the stakeholders in the bank, have not decided to place a cap on the tenure of the CEOs, then the decision of the CBN to do so becomes questionable.<sup>456</sup>

Also, putting a cap on CEO tenure would mean that the role of experience in bank performance is irrelevant. The general belief is that more experience means more efficiency because the longer they stay in office, the more motivated they become and this could lead to better decisions for the banks. The cap on CEO tenure may, therefore, be a hindrance to bank efficiency in Nigeria. The writers believe that on the one hand the CBN has the power to regulate banking activities in Nigeria; however, they argue that where such regulation may impact on banking efficiency, it is bound to raise concerns.<sup>457</sup>

Furthermore, there are the dynamics and peculiarities of each CEO. Having the same cap for tenure for all banks is not taking into consideration the fact that CEOs are different, and each CEO should be addressed in view of their

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<sup>455</sup> Ibid. 39

<sup>456</sup> Ibid

<sup>457</sup> Ibid

qualities and parameters of performance. Also, banks' specific peculiarities should be taken into consideration. These include ownership structure, nature of business, size and volume of transactions, etc. Perhaps CEOs of banks that take greater risks should serve longer tenures than those with lesser risks.<sup>458</sup>

From the above, it can be said that the parameters to which the CBN considered the tenure and then came to the conclusion of ten years is questionable. Issues of Nigeria's peculiarities are not considered because the institutional corruption of the country would mean that tenure of the CEO will do little or nothing to help the situation. A control fraudster can perpetrate fraud in a bank given a minimum amount of time, regardless of how long he serves as CEO.

Lastly, there is the question as to whether or not the tenure policy usurps the powers of shareholders and boards who should freely determine who should run the affairs of the company and how this should be done. This is a fundamental principle of corporate governance. There is yet no principle of corporate governance that grants power to the CBN to regulate tenure of CEOs. Although this is not new to the universal governance of states across the world, it is yet to be recognised in corporate governance.<sup>459</sup>

That notwithstanding, taking into account the specific peculiarities of a country like Nigeria, while the tenure policy remains controversial, it is important to understand that the policy came shortly after the banking crisis and should be seen as a positive gesture on the part of the CBN in preventing future control frauds in banks. Whether or not the policy will work will depend on a number of other factors, as will be unravelled in the course of this thesis.

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<sup>458</sup> Ibid 40

<sup>459</sup> Ibid

### ***5.3.3 Code of Corporate Governance for Banks and Discount Houses in Nigeria 2014***

Recently, the CBN published another Code of Corporate Governance for Banks and Discount Houses intended to be effective from the 1<sup>st</sup> of October 2014. The new Code is meant to be a uniform Corporate Governance Code applicable to Banks and Financial Institutions throughout the country and is to repeal the 2006 Code.<sup>460</sup> The Code was published together with Guidelines for whistle-blowing for Banks and Other Financial Institutions in Nigeria. Notably, the Code has been extended to Discount Houses and compliance is made mandatory as with the previous Code.<sup>461</sup>

The Code begins recognising the problems faced by the banking sector since the last Code, that is, the 2009 banking crisis. The Code therefore begins by focusing on ensuring compliance. It is worth mentioning also that the Code also provides that external auditors are required to report annually to the CBN, the extent of the banks compliance with the Code. It therefore follows that the external auditor is to be adequately competent and knowledgeable with the governance systems operating in Banks and Discount Houses.<sup>462</sup>

It is to be noted that although this new Code, when it becomes effective, will perhaps be the most comprehensive Code governing Banks in Nigeria to date and the Guidelines on whistle-blowing policy will be the first of its kind in Nigerian Banks and this in itself seems to be a positive move, however, the Code is quite similar in form to the SEC Code discussed above and to avoid repetitions, not much of the Code will be further discussed. However, as an improvement from the 2006 Code, certain provisions will be considered.

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<sup>460</sup> CBN Code for Corporate Governance, 2014, s.9  
[http://www.ecgi.org/codes/documents/cg\\_code\\_nigeria\\_16may2014\\_en.pdf](http://www.ecgi.org/codes/documents/cg_code_nigeria_16may2014_en.pdf) accessed 10 October 2014

<sup>461</sup> See the Circular attached to the Code.

<sup>462</sup> Ibid s.1.2 of the Code

Firstly, the Code clearly provides for more robust transparency and disclosure requirements for Banks in a bid to promote effective Corporate Governance. These additional requirements go beyond the statutory requirements of BOFIA, CAMA and other applicable Laws.<sup>463</sup> Section 5.1.2 of the Code provides for the list of information to be included in a company's annual report. These include details of directors, directors remuneration policy, details and reason for share buy-backs, corporate governance including governance structure, composition of the board of directors, loan quality and insider-related credits, risk management, fraud and forgeries, regulatory sanctions and any other matter capable of affecting the financial condition of the bank or its status as a going concern. The legal requirement that this information be included in the annual report would serve as a warning to potential control fraud, knowing that the likelihood of being caught out has increased. It is then left to be seen whether these would in themselves help prevent fraud in Nigerian banks.

Secondly, shareholders' rights and duties are also spelt out and in addition, shareholder access to information has been further widened in the face of growing technology to include websites, emails, etc. as with the SEC Code.<sup>464</sup>

A major development in the Code is in respect of Shareholder Associations. Section 3.5 of the Code provides that the board is to ensure that dealings of the bank with shareholder associations are in accordance with the Code for Shareholder Associations published by the Securities and Exchange Commission. The recognition of the Shareholders Association Code suggests a wider purview of Shareholders' rights and responsibility, bearing in mind that the Shareholders' Association Code aims at developing and

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<sup>463</sup> Ibid s.5.1.1

<sup>464</sup> Ibid s.5

educating shareholders, making them more active, rather than passive, thereby strengthening their role in preventing control fraud.<sup>465</sup>

Further to the above, the Code also provides for transparency and integrity in reporting and stresses the need for banks to disclose all relevant information and Banks have the structure to independently verify and safeguard the integrity and quality of their financial reporting according to Section 5.2. Furthermore, the Banks Audit Committee shall consist of only non-executive directors with a minimum of at least three members and shall be chaired by an independent director.<sup>466</sup> Another notable provision of the Code is the prohibition of non-audit services by the external auditor. The Code goes further to enumerate the said services. These include:

- Bookkeeping or other services related to the accounting records or financial statements of the audit client;
- Appraisal or valuation services, fairness opinion or contribution-in-kind reports;
- Actuarial services;
- Internal audit outsourcing services;
- Management or human resource functions including:
- Broker or dealer, investment banking services and legal or expert services.<sup>467</sup>

This is to prevent conflict of interests and ensure adequate independence.

Whistle-blowing is provided for in Section 5.3 where Banks are required to have a whistle-blowing policy which should be made known to their employees and other stakeholders. The policy is to encourage reporting of any unethical practices of the Bank to the CBN without fear and in

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<sup>465</sup> The Shareholders Association Code is discussed in Chapter eight on Shareholders.

<sup>466</sup> Ibid s.5.2.2 The Section provides for the requirements for appointment of external auditors as well as qualifications of the auditors and tenure.

<sup>467</sup> Ibid s. 5.2.11



confidentiality. Section 7 also provides for ethics and professionalism in banks and also talks about conflict of interest whereby directors are required to disclose any real or potential conflict of interest that they may have in any matter.

On the issue of sanctions in a bid to ensure compliance, Section 8 provides that returns on the status of each institutions' compliance to the Code shall be made every quarter or as directed by the CBN and failure to comply with the Code will attract the penalty provided in Section 60 of BOFIA 1991(As Amended) which may be a fine, suspension of licence or prosecution as the case may be. The Code also provides for the appointment of a Chief Compliance Officer (CCO) who, in addition to ensuring compliance with Anti-Money Laundering and Financial Terrorism issues, is to also monitor the implementation of the corporate governance Code. Therefore the duty to ensure compliance is placed in the hands of the auditors and Chief Compliance Officers whose appointments must be approved by the CBN.

Although, it can be said that the 2014 Code is very comprehensive, taking into account past failures of corporate governance, and going the extra mile to ensure transparency and disclosure. Whether or not the Code will help prevent future control fraud remains to be seen. There is no doubt that a large percentage rests on ensuring compliance to the code and actually enforcing compliance mechanisms. Although the Code may have made adequate provisions on how compliance can be ensured, the problem of non-compliance clearly goes beyond setting up measures and standards to weigh compliance. As explained earlier in this chapter, control frauds go a long way to conceal their fraud and adequate enforcement measures becomes necessary.

So how can this be done? Enforcement is not a matter of making sure rules are followed merely by looking at the books where it says and shows that rules are followed; rather, it comprises looking more closely at the

underlying factors that may prevent compliance to rules to know why control frauds take place in the first place and seeking to eradicate these factors. The factors in question include, social, economic, political and environmental factors and it ranges from poverty to corruption, illiteracy and ignorance to mention a few!

#### **5.4 The Problem of regulatory multiplicity in Nigerian banks.**

The Nigerian corporate governance regulatory terrain can be said to be a trail of conflicting laws where discrepancies occur both in compliance and in principle. Generally, corporate governance regulation in Nigeria suffered from a weak system of regulation as explored throughout the thesis.

As earlier discussed, the major company law in the country governing both listed and non-listed companies is CAMA. The Nigerian banking sector is also regulated by the Banks and Other Financial Institutions Act (BOFIA), which complements CAMA and makes provisions for specific disclosure and reporting requirements for banks.<sup>468</sup> Nigeria has subsequently developed a stream of corporate governance regulations following the global financial crisis that occurred at the time.

The occurrence and implications of corporate governance multiplicity at individual country levels have been understudied in literature. Osemeke and Adegbite<sup>469</sup> examine the conflicts arising from different Codes of corporate governance in Nigeria using a conflict-signalling theory. The authors start by referring to Karl Marx's thinking that human behaviour in social contexts arises from conflicts between competing groups.<sup>470</sup>

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<sup>468</sup> BOFIA, 2004 s.25, 29. Major provisions of the CAMA and BOFIA have been described in detail in Chapter four on Corporate Governance Regulations.

<sup>469</sup> Osemeke, L. And Adegbite, E. (2014) 'Regulatory Multiplicity and Conflict: Towards a Combined Code of Corporate Governance in Nigeria.' *Journal of Business and Ethics* p.1-21

<sup>470</sup> Ibid 3

According to them, although Marx focused on social conflict, conflict theory subsequently evolved to focus on a common belief that social groups have unequal power, even though all groups struggle for the same limited resources.<sup>471</sup> Conflict theory is not only concerned with the needs of the society but that of corporations and focuses on issues such as disagreement between stakeholders.<sup>472</sup> Therefore in examining corporate governance multiplicity, conflict theory helps to understand why there is conflict and the rationale behind boards' decisions of which Code to comply with notwithstanding the conflict within the Codes.<sup>473</sup>

The theory according to Osemeke and Adegbite assumes that the inherent conflicts within the Codes impact on the behaviours of managers and members of the board who were presented with the opportunity to comply with a less rigid Code or outright non-compliance.<sup>474</sup> The subsequent implication of this conflict therefore sends mixed signals, (what the authors call 'signalling theory') to regulators and investors where friction exists between stakeholders which may lead to bad corporate practices.<sup>475</sup> The totality of communication between companies, individuals and regulatory agencies becomes the focus of the signalling theory. The consequence of the theory lies in its implication for corporate reporting and disclosures whereby managers may use their position and access to information for their own benefit rather than that of other stakeholders. This may create an avenue for control fraud whereby executives decide to comply with the Codes that can easily be manoeuvred for their own benefit. They use the Codes to their advantage by making sure they comply only in principle but not in action.

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<sup>471</sup>Ibid (Referring to Letza, S. Kirkbridge, J., Sun, X. & Smallman. C. (2008) 'Corporate Governance Theorizing; Limits, Critics and Alternatives.' 50(1) *International Journal of Law and Management*, 17-32

<sup>472</sup> Ford, C & Hess, D (2011) 'Corporate Monitorships and new Governance Regulation: In theory, In practice and In context' 33(4) *Law and Policy*, 509-541

<sup>473</sup> Osemeke and Adegbite (n.699)

<sup>474</sup> Conflicts within the Codes are discussed subsequently in this chapter

<sup>475</sup> Osemeke and Adegbite Ibid

Furthermore, Rothschild and Stiglitz suggest that companies with good information transparency can signal good corporate governance through good reporting.<sup>476</sup> In this situation, signalling would act as a form of screening device for shareholders to select the best companies for investment. Signalling theory therefore helps to play a motivational role for company disclosure. Osemeke and Adegbite conclude that both conflict and signalling theories help to complement each other in understanding how regulatory cohesiveness guides the behaviours of managers and companies in terms of compliance to corporate governance regulation.<sup>477</sup> However, the multiplicity of Codes on the other hand is problematic to the effect that where a company may cite multiplicity as its reason for non-compliance, using it to conceal the true nature the company and the multiplicity itself can be used as a shield and weapon for fraud.

Osemeke and Adegbite investigate the growing dissatisfaction with regards to the conflicts among the Codes. They find that people believe the problem is that of the regulators' quest for power and relevance, leaving companies to bear the cost. The constant irregularity and conflict with the Codes seem to be self-indulgent.<sup>478</sup> In their survey, they found that there is a general belief that the industry-specific Codes are more effective than the SEC Code because of their mandatory provisions. The survey further revealed that the conflicts in the Codes can be likened to the fact that they were copied from developed countries, particularly the UK and USA.

As emphasized by one of the participants:

‘.....the CBN Code is copied from the US while the SEC Code is copied from the UK. Is it possible for Nigeria to

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<sup>476</sup> Rothschild, M & Stiglitz, J. E.(1976) ‘Equilibrium in Competitive Insurance Markets: An Essay on the Economics of Imperfect Information.’ 90(4) *The Quarterly Journal of Economics* 629-649

<sup>477</sup> Osemeke and Adegbite Ibid

<sup>478</sup> Ibid 8

develop their regulatory standard that suits our culture of togetherness and inclusiveness and suits our environment and society? ...our people should not be subjected to copying; otherwise, they should expect conflicts in implementation and practice. This is why we as managers are confused as to what to do. Most times, we ignore the Codes but for record purposes, we tick the boxes as a signal for compliance to the Codes and for auditing purposes... we just do it to avoid pressures from the regulators'<sup>479</sup>

The results of their survey confirmed that over 67% of respondents believed that there are discrepancies in the Code, a number which is of great concern to stakeholders.<sup>480</sup>

Regulatory multiplicity is a very grave issue in Nigeria. It is important that this problem is addressed in order to prevent an avenue for future control frauds. In this regard, a good suggestion would be that regulators work together to co-ordinate their Codes in order to create a unified system of corporate governance in the country so that corporate participants are clear on the rules in place. This would also provide for a more feasible possibility of working together to promote efficiency within the system.

In the sub-sections that follow, notable areas of conflict will be analysed to the extent that they create regulatory multiplicity and an environment that could foster control fraud.

#### ***5.4.1 Board Size and Independence***

Board size and independence has remained an area of concern in Nigerian corporate governance. The issue of how many members should be on the

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<sup>479</sup> Ibid (quoting one of their focus group respondents)

<sup>480</sup> Ibid

board, how many executive and non-executive directors and how many should be independent directors has been a subject of debate.<sup>481</sup> It is important to state that the Codes to be compared below will be the post-crisis Codes, that is the SEC Code of 2011 and the most recent CBN Code of 2014. This is to focus on whether or not the present corporate governance regulations can help prevent future control frauds in Nigerian banks.<sup>482</sup>

To start with, both the CBN and SEC Codes have various provisions regarding board size and independence and every time a new Code comes out, it creates even more ambiguity on the issue. For example, where the Code provides for non-executive directors to be independent, it goes on to say that the number of independent directors should be at least one.<sup>483</sup> Furthermore, the SEC Code provides that the number of board size should be a minimum of 5.<sup>484</sup> It fails to provide the maximum number of board. Also, the ratio of executive to non-executive directors is not provided for in the Code. What is seen in S. 4.3 is that the board should be comprised of a mixture of executive and non-executive directors and the ratio of non-executive directors should be more than that of executive directors. The Code further provides that at least one of the non-executive directors should be an independent director.

Furthermore, the Code fails to clarify the issue of independent directors. According to the Code, a public company should have at least one independent director.<sup>485</sup> Section 4.3 provides that the board should comprise both executive and non-executive directors of which at least one of them

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<sup>481</sup> See Osemeke, L. and Adegbite, E. Ibid; Baysinger, B.D. and Butler, H.N.(1985) 'Corporate Governance and the Board of Directors: Performance Effects of Changes in Board Composition' 1(1) *Journal of Law, Economics, & Organization* 101-124, Bermig, A. and Frick, B. 'Board Size, Board Composition, and Firm Performance: Empirical Evidence from Germany' (June 10, 2010). <http://ssrn.com/abstract=1623103> accessed 20 October 2014

<sup>482</sup> These Codes have been dealt with in detail earlier in this chapter.

<sup>483</sup> SEC Code, 2011 s.4.3

<sup>484</sup> Ibid s. 4.2

<sup>485</sup> Ibid s. 4.3, 34.4(a)

should be an independent director. Bearing in mind that an independent director is a non-executive director who is detached in the company and management so much so as to be independent in character and judgment and his main obligation is to promote the best interests of the company. The role of the independent director is therefore at the forefront of effective corporate governance and prevention of control fraud because he acts with the best interest of the company at heart and is therefore likely to be free and fair.

It is important to mention that all independent directors are non-executive directors but not all non-executive directors are independent directors. It therefore follows that although a company may have a fair amount of non-executive directors on its board, it may still be lacking in independent directors who will be fair in character and judgment. Best practice will therefore be for the majority of members of the board to be independent non-executive directors so as to ensure an unbiased corporate environment, which may open the door for control frauds to take place. For instance, in the UK, Section B.1.2 of the 2012 UK Code of Corporate Governance provides that: ‘Except for smaller companies, at least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent.’<sup>486</sup> There is therefore no gainsaying that the role of independent directors is very important and unless they are substantial in number as to have collective impact, most importantly in working together to prevent control fraud, their role may be undermined. The approach adopted in developed countries is that they constitute the majority of the board members.<sup>487</sup> This is to ensure a situation where independent directors can influence board decisions. But in a situation where a public company only has a minimum of one independent director, the ability to influence decisions may be practically impossible.

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<sup>486</sup> A smaller company is one that is below the FTSE 350 throughout the year immediately prior to the reporting year. See the UK Code of Corporate Governance, 2012. Available at <http://www.slc.co.uk/media/78872/uk-corporate-governance-code-september-2012.pdf> accessed 1 July 2014

<sup>487</sup> This is the approach adopted in the UK and USA.

Notably, the recent 2014 CBN Code addresses the issue of board size and composition when it provides that the size of the board shall be limited to a minimum of 5 and a maximum of 20.<sup>488</sup> The maximum number provided for, which is 20, seems to clarify the issue here but will banks follow the CBN or SEC Code? Perhaps the mandatory nature of the CBN Code would suggest that banks must comply with the recent CBN Code. However, the irregularity in board size and composition is further compounded by the number of independent directors. While the SEC Code provides (as explained above) for the number of independent directors to be at least one non-executive director, the CBN Code provides that the number of independent directors for banks should be at least two non-executive directors. It therefore becomes a concern as to whether or not these irregularities may pave the way for future control frauds. This is because prior to the crisis, the 2006 CBN Code stated that the number of independent directors should be at least two who should not represent any shareholder's interest, or hold a special interest in the bank, and should be appointed by the bank on merit.<sup>489</sup>

While there is no evidence to suggest how many independent non-executive directors there were for each of these banks, it is safe to say that they each had at least two independent non-executive directors and it remains to be seen whether they were indeed independent and appointed by merit as the Code prescribed. Clearly this was not enough to prevent the control fraud, hence, the need to at least improve the number of independent non-executive directors as a positive step towards preventing future control frauds in Nigeria. It is therefore right to say that for Nigeria to tackle the institutional problem of fraud which has eaten deep into Nigerian banks, it is important to ensure that independent non-executive directors constitute the

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<sup>488</sup> CBN Code, 2014 s.2.2.

<sup>489</sup> CBN Code, 2006 s.5.3.6



majority of board members and this is more likely to help prevent future control fraud in banks.

#### **5.4.2 Chairman/CEO Appointment**

Although both the SEC and CBN Codes clearly separate the roles of the Chairman and CEO, irregularities occur in the form of appointment. The CBN Code expressly states in Section 2.3.3 that no two members of the same extended family should occupy the roles of chairman and CEO at any one time. It is important to state that the 2014 Code does not define the term 'Extended Family'. However this is defined in Section 5.2.3 of the 2006 CBN Code and it refers to members of a nuclear family, comprising the husband, wife and their siblings including parents and brothers/sisters of both the husband and the wife.<sup>490</sup>

It is pertinent to note that the SEC Code is simply silent on the matter. It makes no provision whatsoever regarding extended family members serving as chairman and CEO at the same time, which will therefore mean that although the Code separates the two roles, it gives room for family members to occupy both positions which will then mean that the so-called separation is only in words but not in practice. This obvious conflict will send various signals to managements and companies who get confused as to what to do; it becomes a problem if two deserving people for these positions turn out to be members of the same family. Do you employ them? A professional answer would be to interpret the Code using the old mischief rule<sup>491</sup> to the effect that the history of the Code is understood in order to determine the reason why the Code came to being in the first place, to investigate what the Code was meant to correct; and by so doing it would only be fair not to

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<sup>490</sup> Ibid s. 5.2.3

<sup>491</sup> This is an old common law interpretation. The mischief rule is a means of interpretation of a statute that takes into consideration the mischief in a statute in order to find a remedy for it. The courts while applying the rule tries to find the real intention behind the enactment. See <http://definitions.uslegal.com/m/mischief-rule/> accessed 23.10.14

allow two members of the same family to occupy the positions at any one time. This is because a close look at the events surrounding the SEC Code, and most importantly the control frauds in banks, will lead one to the conclusion that the Code is meant to correct the demeanour of CEOs and bank managers.

Would it then be of any use if the same Code was being interpreted to mean that family members could still occupy the positions of Chairman and CEO at any one time when the Code is intended to curb the excesses of CEOs and Chairmen themselves? In essence, how can control fraud be reduced in Nigerian banks if this was still the case? Looking at these questions, it seems that interpreting the Code in line with its intended remedy will help to achieve its purpose. Perhaps a lasting solution to the irregularity would be for the CBN and SEC to coordinate their Codes in order to avoid the conflicts that could pave the way for future control frauds.

#### ***5.4.3 Audit Independence***

Another area where there is discrepancy lies in the issue of Audit committees. The SEC Code provides that every public company is to establish an audit committee in accordance with Section 359 (3) and (4) of CAMA. This is to the effect that the audit committee is to consist of an equal number of independent directors and representatives of the shareholders to a maximum of six. This is however contradictory to the CBN Code which provides that the Banks Audit Committee (BAC) should consist of at least three members, should be made up of only non-executive directors and should be chaired by an independent director.<sup>492</sup>

The discrepancy regarding composition of the audit committee would create ambiguity in the selection process. Companies are torn between what calibre of people should be on the committee. If CAMA suggests that shareholder

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<sup>492</sup> Ibid s. 5.2.2

representatives should be part of the audit committee, clearly, it is a way to promote adequate representation of stakeholders in the audit committee. However, the suggestion by the CBN that the committee should only be made up of non-executive directors would mean that shareholders or other stakeholders are excluded from having a say in the audit committee. How then can we promote adequate checks and balances when only non-executive directors are on the audit committee? Also, the Code does not stipulate whether or not the non-executive directors should be independent directors, therefore, the issue of independence of the audit committee becomes a concern.

Furthermore, there is the issue of external auditors and non-audit services. No doubt, while the CBN Code provides that non-audit services are prohibited due to conflict of interest and goes further to highlight the particular services that are prohibited,<sup>493</sup> the SEC Code merely provides that where non-audit services are provided, the audit committee is to ensure that there is no conflict of interest. There is a presumption that non-audit services may be provided in as much as the audit committee are satisfied that there is no conflict of interest.<sup>494</sup> This would then suggest that there may be some non-audit services that could be provided while still maintaining independence of the external auditor. The problem with the SEC Code here is that it fails to list such services for the purposes of clarity. This is a very important provision as non-audit services are very vital to external auditor independence and it would be worth taking time to enumerate the kind of services that may be permitted under the Code. Another way of interpreting this provision is to consider the fact that perhaps there are indeed non-audit services that are conflict-free hence the reason for not listing same.

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<sup>493</sup> CBN Code, 2006 s. 8.2.4

<sup>494</sup> SEC Code, 2011 s.30.4(k)

As will be examined in the chapter on Auditors, the external auditors in Nigeria provided both audit and non-audit services. There is therefore no doubt in saying that auditor independence has been impaired. Perhaps a good suggestion would be for CAMA to specifically prohibit non-audit services as this term is not mentioned in both soft and hard laws in Nigeria. It is important to clearly state the term in both the laws and Codes so as to provide adequate clarity on the issue.

### **5.5 Should Corporate Governance Regulation be rules-based or principles-based?**

The success of corporate governance can be said to be based on a totality of environmental factors within which firms operate.<sup>495</sup> These include the legal environment which comprises laws and policies, the corporate environment which is made up of business ethics and corporate relationship and also the regulatory environment which is made up of enforcement bodies such as the judiciary and other regulatory bodies like CBN and SEC in Nigeria. The totality of these can be said to be corporate governance regulation.

Since the global banking crisis of the last decade, considerable attention has been drawn to regulating corporate governance across the world. Nigeria is therefore not left behind in the need to promote good practices of corporate governance in Sub-Saharan Africa.

As the most populated country in Africa, the country still remains largely underdeveloped and is therefore devoid of standardised economic and political development. The level of corruption in the country is also a hindrance to the corporate environment which impacts on international investment and financial performance in the country.

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<sup>495</sup> La Porta, R, Lopez-de-Silanes, F. Shleifer, A. And Vishny, R. (1998) 'Law and Finance' 106(6) *Journal of Political Economy* 1113-55

That notwithstanding, active debates have been made towards regulating corporate governance from scholars, writers, regulators, legislators and also professional bodies. The arguments are being proffered twofold. Firstly, there is the notion that corporate governance regulation should be rules-based. To this effect, Proimos argues that good corporate governance is a measure of compliance to legal requirements followed by penalties for breach;<sup>496</sup> it therefore becomes impossible to separate corporate governance from law. The measure of a country's compliance to effective corporate governance is determined by the level of increase or decrease in the number of cases that have been punished for non-compliance. He further argues that the provision of general guidelines are not in themselves effective, but rather a legal framework that spells out the penalties for non-compliance and becomes the solution to the problem.<sup>497</sup> His conclusion therefore is that only rules-based corporate governance whereby statutes and laws are in force is the only way to prevent future corporate crisis. The most obvious example of rules-based corporate governance is the USA where in the aftermath of Enron and other major corporate scandals, the enactment of the Sarbanes Oxley Act was seen as a proactive measure to prevent future scandals.<sup>498</sup>

Secondly, there is the premise that corporate governance should be principles-based. This is based on more soft-law remedies for good corporate behaviour. The United Kingdom is a good example of principles-based corporate governance whereby the adherence to corporate governance principles is seen as a voluntary measure whereby firms are encouraged to

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<sup>496</sup> Proimos, A. (2005) 'Strengthening corporate governance regulations, 6(4) *Journal of Investment Compliance* 75 – 84

<sup>497</sup> Ibid

<sup>498</sup> Subsequent financial crisis since the enactment of the Act shows that more is needed, and the Act might have been an overreaction to extreme events. (Surenda, A, (2006) 'Striking a Balance between Rules-based and Principles based Approaches for Effective Governance: A Risk based Approach' 68 *Journal of Business Ethics* 53-82 at p. 54) it is however imperative to mention that the existence of the Act alone will serve as a warning for corporate participants to guide their actions in the course of their duties. Perhaps the fear of being punished alone has helped to curb future scandals.

adhere to corporate governance practices with the introduction of the comply or explain principle. The problem then lies on getting the best approach to effective corporate governance.

In the consideration of the US reaction to the corporate scandals of Enron, WorldCom and Tyco, Greenfield posits that the introduction of a rules-based system might be a rush in an attempt to 'fix' the things that may not be the parts that are broken.<sup>499</sup> According to him, two assumptions underlie the rules-based system. First is the failure of corporate governance systems, fall in financial markets and loss of investor confidence; second is the attempt to get rid of the 'bad apples'<sup>500</sup> in order to get on with business. Greenfield further argues that neither of these assumptions will solve the problem. Trevino and Brown also claim that the first reaction to ethical problems is to find and punish the culprit.<sup>501</sup> This is to serve as a 'scapegoat' for others and to create decorum in the organisation. The problem however is that although the perpetrator has been found and punished, the damage done is left behind and leaves a complacent environment behind.

The idea that by getting rid of one or more of the bad apples in the organisation, all will be well, leads the authors to conclude that most people are the product of the corporate environment in which they find themselves and therefore one can say that most fraud is supported either directly or indirectly by the context within which it occurs.

In terms of control fraud, where the CEO uses 'yes men' to perpetrate fraud, it is possible that getting rid of the CEO will not necessarily get rid of all the allies to the fraud, therefore it is possible that other people in the system may carry on locally in their own capacity.

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<sup>499</sup> Greenfield, W.M. 2004: 'Attention to People and Principles is key to Corporate Governance and Ethics' 30(4) *Employment Relations Today* 6-10

<sup>500</sup> These are the few individuals that have corrupted the corporate environment and therefore damaged the reputation of companies.

<sup>501</sup> Trevino, L and M. Brown (2004) 'Managing to be Ethical: Debunking five business Ethics Myths' 18(2) *Academy of Management Executives* 69-81

The challenge therefore is to develop a corporate culture of trust, integrity and intellectual honesty while also promoting the common law duties of good faith, diligence, care and skill. Companies tend to rebel against a rigid set of rules but are more attracted to a wider system that embraces the socio-economic needs of the company.

Berenbeim<sup>502</sup> considers that effective corporate governance is a question of recognising human and institutional limitations as well as vigilance. However, he goes further to state that all these factors become irrelevant when markets rise. He then makes four suggestions that can help promote corporate governance. Firstly is in the issue of independence. Rather than focusing on promoting independence, a good knowledge of the cultural environment in which the board operates is far more important than concentrating on separation of the roles of CEO and Chairman. It is important to know the cultural dynamics which affect the day-to-day activities of the board. Secondly, director independence should be encouraged through employing competent directors, allocation of adequate resources to the board and regular meetings of non-employee directors. Thirdly, the requirement that boards certify financial statements may be beyond boards' competence and fourthly is the promotion of more involvement in company ethics and compliance.<sup>503</sup>

It is important to mention that any form of corporate regulation should take into consideration both rules and principles in order to adequately regulate the corporate environment. According to Adegbite, in many countries, both propositions of corporate governance regulations are not mutually exclusive; self-regulation actually functions on a preceding legal platform for corporate regulation.<sup>504</sup> Ranking countries according to rules or

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<sup>502</sup> Berenbeim, R. 2004, 'Corporate Governance: Giving Ethics Operational Meaning' 71(3) *Vital Speeches of the Day*, 87-89

<sup>503</sup> Ibid

<sup>504</sup> Adegbite, E. (2012). 'Corporate governance regulation in Nigeria.' 12(2) *Corporate Governance: The international journal of business in society*, 257.278

principles-based corporate governance would therefore suggest that corporate governance is country specific.

The next issue to consider is whether or not Nigerian banks will benefit from a rule-based or principle-based system. Although the present trend in the country seems to be the rules-based system owing to a number of corporate governance Codes that have been developed since the banking crisis of 2009, Nigeria's corporate governance system is made up of a combination of both legal and policy regulation which also includes soft laws, the only difference is that in the rules-based system, compliance is mandatory as opposed to the voluntary nature of the principles-based system. Indeed the country has seen a transition from voluntary to mandatory over the last few years in the banking industry. It is therefore safe to suggest that given the institutional configurations of the country; perhaps a rules-based system where compliance is mandatory will go a long way in helping to reduce corruption and control fraud in the country.

## **5.6 Overview of the proposed Financial Reporting Council (FRC) of Nigeria National (Draft) Code of Corporate Governance (NCCG), 2015**

It is important to discuss the controversial FRC draft unified Code of corporate governance, 2015 and its implications for Nigerian banks.

In 2013, the Minister for Trade and Investment set up a steering committee to unify all existing Codes of corporate governance in Nigeria; this is premised on the multiplicity of the Codes which have created confusion regarding compliance.<sup>505</sup> The committee was charged mainly with the aim of developing a unified Code that will promote highest standards of

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<sup>505</sup> The Code is to unify the present corporate governance codes setup by six bodies namely the CBN, SEC, National Insurance Commission (NAICOM), Pension Commission (PENCOM), Corporate Affairs Commission (CAC) and National Deposit Insurance Commission (NDIC).



corporate governance, enhance public awareness to corporate governance standards, promote sound internal control systems and enhance adequate financial reporting and audit systems.<sup>506</sup>

The Code was divided into three parts; public sector, private sector and non-profit organisations. Notable aspects of the Code are summarised below.

To start with, the Code provides an exhaustive list of the functions of the board, stressing that the board is central to corporate governance. Duties of the board include leadership, accountability, risk management, as well as appointment and removal of internal audit committee.<sup>507</sup>

Furthermore, Section 5.6 provides that the minimum number of board directors should not be less than 8 and in the case of small companies, the regulator may prescribe the minimum number of independent non-executive directors in line with both minority and majority stakeholders' interests.<sup>508</sup> However, the term 'small company' is not defined in the Code and the prescribed number of 8 may cost more in terms of remuneration and the number also contradicts the CBN and SEC Codes which provides for a minimum number of 5.<sup>509</sup>

Also, the Code provides that the number of executive directors should not be more than one-third of the board and the non-executive directors should not be less than two-thirds of the board.<sup>510</sup> The result of this, however would lead to increase in governance costs because existing companies will have to increase the number of their board members. For example, a company with 6 executive directors will have to increase its non-executive directors to 12, making a total of 18, which will impact on remuneration and governance

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<sup>506</sup> See the Draft National Code of Corporate Governance for Private Companies in Nigeria, 2015, S.1.1

<sup>507</sup> See generally NCCG, 2015, s.4

<sup>508</sup> NCCG Code, 2015, s. 5.6

<sup>509</sup> See for instance SEC Code, 2011, s.4.2

<sup>510</sup> NCCG Code, 2015, s.5.4, 5.5(a)

costs on the company. The Code further provides that the number of independent non-executive directors should not be more than half of the non-executive directors.<sup>511</sup> This can be said to be a good improvement as it will provide for greater transparency and accountability.

As regards audit committee, the Code provides that the board audit committee should comprise at least three members, who must be non-executive directors, and majority of which shall be independent non-executive directors.<sup>512</sup> The Code also provides that the internal audit committee as set out by the board must develop an internal control framework for the company and obtain annual assurance report on the effectiveness of the internal control framework.<sup>513</sup> It further provides that the head of the internal audit committee must be a member of senior management.<sup>514</sup> Placing this position in the hands of a senior management may not necessarily provide a fair process of accountability and checks and balances as the role of senior management role itself poses the risk of control fraud. The Code also provides for appointment of external auditors who are to work with the internal board audit committee on appointment and removal of external auditors.<sup>515</sup> Furthermore, the Code provides that listed and public interest companies should employ joint auditors for their statutory audit, and it goes on to define public interest companies as those whose capital is not less than N1 billion and annual turnover not less than N10 billion.<sup>516</sup> While mandatory joint audit may provide a second opinion on an audit, it is not a guarantee for better audit performance or a more scrutinized audit. Furthermore, the use of financial constraints to define public interest companies may be problematic because companies can

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<sup>511</sup> Ibid, s.5.5

<sup>512</sup> Ibid s, 18.14.5

<sup>513</sup> Ibid, s.8.14.10 (c)

<sup>514</sup> Ibid, s.17.15

<sup>515</sup> Ibid s. 19.1

<sup>516</sup> Ibid s.19.2.1

experience fluctuations in turnover which will lead to inconsistent categorization.

The Code also provides for mandatory audit firm rotation after five years and leaves a five year cooling off period after which a previously engaged audit firm could work for the same company.<sup>517</sup> Although this seems to be a positive step, whether or not audit rotation will help improve corporate governance and prevent the likelihood of fraud remains to be seen.

Furthermore, the Code makes provision for shareholder involvement, taking into account both majority and minority shareholders and encourages constant relationship between board members and shareholders.<sup>518</sup>

It suffices to say that the new FRC Code will be mandatory when released. However, it should be mentioned that the Code is not yet in force and has been highly contested mainly based on its 'one cap fits all' approach which have raised concerns. Furthermore, it can be said that the FRC Code is not sufficient to address the issues raised throughout the course of this research. It is important to stress that the role of each participants in corporate governance needs to be enhanced if control fraud is to be reduced in Nigerian banks.

## **5.7 Summary and Conclusion**

This chapter aimed at investigating the evolution of corporate governance Codes in Nigeria. It was the focus of this chapter to analyse the various Codes of Corporate Governance that are in existence in Nigeria with a view to understanding whether or not adequate regulations are in place targeted towards preventing control fraud. It can be seen that Nigeria's corporate environment consists of a combination of Company Law and Corporate Governance Codes.

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<sup>517</sup> Ibid. S.19.3

<sup>518</sup> Ibid, s.20

A thorough examination of the Codes would reveal that the Codes in themselves are not sufficient. It must be mentioned that the existence of the above Codes did not prevent the Banking Crisis of 2009, notwithstanding the existence of various corporate governance Codes aimed at promoting effective corporate governance in place at the time. Also, the lack of shareholder education doesn't seem to help. In a situation where shareholders are ignorant of their rights and powers and do not know how and when to ask questions, shareholders that are mainly concerned with dividends and financial performance of the company will find it difficult to pay attention to details or even attend meetings where relevant issues are discussed. Nigeria has only recently begun shareholder education and enlightenment following the banking crisis and it is hoped that shareholders will become more confident in the use of their powers and privileges. Perhaps with the introduction of the 2014 Code with recognition for the Shareholder Association Code, more may be expected from Shareholders.

Furthermore, the CBN Code had a massive case of non-compliance, even though compliance was expressly stated to be mandatory. It was discovered that Banks were able to falsify their accounts so much so that the CBN failed to detect for a long time. It therefore follows that if even mandatory rules could be sidelined, what then can be said for persuasive/comply or explain rules in Nigeria? The answer obviously would be that they will be simply ignored with little or no explanations given.

In conclusion, although the new 2014 Code seems promising with the provision of sanctions for non-compliance to corporate governance policies, it doesn't seem to be the solution that Nigeria needs at present. In addition, the proposed unified Code of corporate governance for companies has been identified as a 'one cap fits all' approach, which does not seem to be the solution that banks need. It is important to reiterate that banks are a peculiar institution with unique governance mechanisms, therefore a peculiar Code is required that will take into consideration corporate governance as it applies

to banks alone. In this regard, regulatory bodies such as the CBN and SEC need to be aware of the need to work with other corporate participants to reinforce their enforcement mechanisms rather than providing new laws from time to time. This means that enforcement of existing Codes for banks rather than replacing them with new ones should be the focus. The failure of the 2006 CBN Code seen in the banking crisis of 2009 would lead one to believe that the problem of corporate governance in Nigeria remains an institutional one of enforcement and until the underlying causes of these problems are addressed, mere introduction of new Codes from time to time would only help to compound the problem, rather than solve it. It is the job of each corporate participant to understand that preventing future control fraud is a collective responsibility not for regulators or lawmakers alone.

## Chapter 6

### The regulatory involvement of the Central Bank of Nigeria in the banking crisis

#### 6.1 Introduction

The global financial crisis of 2007 reiterated the enormous influence of financial institutions on the economy and politics. In Nigeria, the financial crisis of 2009 showed the importance of the Central bank of the country, particularly in prudential regulation. The Central Bank of Nigeria (CBN) Act of 2007 charges the CBN with the overall control and administration of monetary and financial sector policies of the Federal Government.<sup>519</sup> Saddled with the responsibility of administering the Banking and Other Financial Institutions Act (BOFIA) of 1991 (As amended), the sole aim of the bank is to ensure high standards of financial stability and ultimately, the promotion of an efficient money system.<sup>520</sup> This role is carried out both directly and indirectly. On the one hand, the central bank is a lender of last resort and a guarantor of net payments systems whereby they are ultimately responsible for the resolution of potential bank crisis. On the other hand, they are indirectly responsible for regulatory functions through design of financial structures targeted toward economic stability.

In this regard, it is the focus of this chapter to explore the activities of the Central Bank in the banking crisis of 2009. Using the five banks as case studies, the chapter seeks to investigate the ways in which the central bank performed its regulatory functions before, during and soon after the banking crisis. It is important to note that the activities of the Central Bank during the crisis, particularly in sacking the CEOs of the affected banks and

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<sup>519</sup> The objectives of the CBN will be discussed in detail subsequently.

<sup>520</sup> CBN Act, 2007 s.2. See also the CBN Website:

<http://www.cenbank.org/AboutCBN/> accessed 3 July 2014

subsequently bailing out the banks have generated a lot of criticisms. The chapter will commence with an investigation of the legal and structural composition of the Central Bank followed by the operational role of the bank. There will then be an analysis of the activities of the Central Bank during the crisis in order to explore factors responsible for the CBN's failure to detect the potential solvency problems of the banks as part of their supervisory and regulatory role. The chapter suggests that regulatory role of the CBN is crucial to corporate governance; therefore, the CBN should be structurally improved to provide a more susceptible atmosphere for the prevention of control fraud.

## **6.2 Overview of the Central Bank of Nigeria**

The Central bank of Nigeria, also known as the CBN, is regarded as the apex bank in the country. The CBN is the top regulatory authority in the Nigerian financial system. Established by the CBN Act of 1958, it commenced full operation on 1 July 1959<sup>521</sup> with the enactment of the Banking Act and with an initial capital of £17.0million. In 1969, the Banking Decree was also established which fully legalised banking businesses in the country. The establishment of the CBN ushered in the beginning of banking regulation in the country. The Bank is responsible for formulating and implementing monetary and financial policies to achieve and maintain economic stability.

Following the repeal of the Banking Act of 1959 and the Banking Decree of 1969, the Banks and Other Financial Institutions Decree (BOFID) was promulgated in 1991, which further empowered the CBN in its regulatory and supervisory function in the country. By virtue of the Decree, both banks and non-banking financial institutions were brought under the purview of

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<sup>521</sup> Barros, C. P., & Caporale, G. M. (2012) 'Banking Consolidation in Nigeria, 2000–2010.' 13(3) *Journal of African Business*, 244-252.

the CBN. The Decree therefore empowered the CBN as the Chief Regulator of banking activities in Nigeria.

In 1994, the CBN therefore established the Financial Services Regulation Coordinating Committee (FRSCC) as part of a regulatory initiative directed towards effective oversight of the financial sector.<sup>522</sup> Members of the committee included the CBN, the Securities and Exchange Commission (SEC), Corporate Affairs Commission (CAC), Ministry of Finance and the Nigerian Insurance Commission.<sup>523</sup>

Sadly, the CBN did not enjoy its autonomous structure for long as the enactment of the CBN Amendment Decree No.3 as well as the BOFI (Amended) Decree No. 4 in 1997 effectively gave the Federal Ministry of Finance control over bank supervision and regulation, therefore giving the CBN little or no power in relation to bank supervision and regulation.

The autonomy was later restored, although to a limited level in 1998 where the 1997 Decrees were further repealed in by the CBN Amendment Decree No 37 as well as the Banks and Other Financial Institutions Decree No 38 of 1998, therefore, the regulatory power of the CBN was restored, granting it power to carry out its functions, particularly with regards to revoking banking licences.

Finally, in 2007, a further CBN Act was enacted which repealed the CBN Act of 1991. By virtue of the Act, the CBN became a full autonomous body with a broader scope of advising the federal government of economic affairs. Section 1(3) of the CBN Act provides that the CBN shall be an independent body in the discharge of its functions, performance of its objectives (which are set out below), and in the promotion of economic

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<sup>522</sup> It is important to mention that the committee was officially inaugurated in 1999 following amendments to the CBN Act in 1991 and 1998.

<sup>523</sup> It is important to state that this chapter will focus on the activities of the CBN



stability. Section 1(2) of the CBN Act also provides the principal objects of the bank. These include:

- Ensuring monetary and price stability
  - Issuance of legal tender currency in Nigeria
  - Maintaining the external reserves to safeguard the international value of the legal tender currency
  - Promoting sound financial system in Nigeria
  - Acting as a banker and providing economic and financial advice to the Federal government.<sup>524</sup>

The CBN Governor and deputy are to be appointed by the president upon approval by the Senate. Section 8(5) of the Act provides that the Governor is to keep the president informed of the affairs of the bank from time to time, and make formal reports on the activities within the bank and economic performance to relevant committees of the National Assembly.

### **6.3 The Operational role of the CBN**

Goodhart<sup>525</sup> identifies two main functions of the Central bank. This includes micro-economic and macro-economic functions. Macro-economic functions include issues of monetary, price and financial stability, while micro-economic functions have to do with the regulation of the financial system. According to him, these two functions of financial stability and financial regulation are interrelated because irrespective of the Central Bank's focus on price stability and monetary balance in any economy (the macro-economic functions), the achievement of this rests mainly on the micro level

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<sup>524</sup> CBN Act, 2007 s.1 (2), Bamanga, M. A. (2010). The current crisis and macroeconomic statistics: statistical initiatives and challenges at the Central Bank of Nigeria. *25IFC Bulletin*, 454

<<http://www.bis.org/ifc/publ/ifcb34af.pdf>> accessed 6 December 2013.

<sup>525</sup> Goodhart, C. A. (2002). The organizational structure of banking supervision. 31(1) *Economic Notes*, 1-32.

stability in the financial system and banking system, as well as the smooth operation of the financial system in a broader sense.<sup>526</sup>

In this regard, the need for the Central Bank to be in substantial relationship with supervisory bodies remains paramount to its operational role of financial stability and regulation. This *amour propre* as identified by Goodhart could be detrimental to smooth flow of information and lack of independence, hence the need for supervisory bodies in charge of banking supervision and the arm of the Central Bank charged with financial stability to work hand-in-hand, irrespective of its operational role and organisational structure.<sup>527</sup>

Following from the above, it can be said that the organisational structure of banking supervision and the Central bank varies according to jurisdictions and other institutional factors and could mean that preference is given to one over the other.<sup>528</sup> For instance, where the organisational structure works hand in hand with the Central bank, one issue that may arise would be that the organisational structure may want to control the category of people that would be involved in banking supervision, and influence the culture of the organisation in which they work. However, inasmuch as the need for Central banks to work with bank supervisors continues to grow, the best scenario will be to keep banking supervision within the central bank. Such internalisation, as argued by Goodhart, will allow for the enhancement of information flows and facilitation of decision-making.<sup>529</sup>

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<sup>526</sup> Ibid 2

<sup>527</sup> Ibid

<sup>528</sup> See Goodhart, C. And d. Schoenmaker (1995a) *Institutional Separation between Supervisory And Monetary Agencies in the Central Bank and Financial Systems* ed. C.A.E. Goodhart London: Macmillan. Chapter 16. See also Goodhart, C. And D. Schoenmaker 'Should the functions of Monetary policy and Banking supervision be separated?' 40 *Oxford Economic Papers*, 539-60

<sup>529</sup> Goodhart, C. A. (2002). 'The organizational structure of banking supervision.' 31(1) *Economic Notes*, 32. 5

Although, the interrelationship between both roles would ordinarily warrant that they should be performed by a single entity, it is pertinent to consider the arguments for separation and fusion of the operational role of the central bank in developed and developing countries consecutively.

#### **6.4 The Supervisory role of the CBN**

In furtherance of the powers and functions conferred on it by the CBN Act,<sup>530</sup> the CBN has all the functions and powers, as well as the duties, granted to it under the BOFIA. The CBN's role of banking supervision is further reiterated in Section 1 of the Banks and Other Financial Institutions Act (BOFIA) of 1991 (as amended).<sup>531</sup> Also, the CBN may appoint an officer of the bank to perform any of its functions under the Act and in some cases, appoint an outsider to render such assistance as necessary in the performance of its functions on behalf of, and in the name of the bank.<sup>532</sup>

Furthermore, in the performance of its principal objectives stated above, particularly in ensuring price and monetary stability, the role of banking supervision becomes paramount to the CBN. Section 42 of the CBN Act therefore provides that the bank shall cooperate with other banks in Nigeria to ensure high standards of conduct and management throughout the banking system.<sup>533</sup> In order to supervise financial institutions, Section 43 further establishes the Financial Services Regulation Supervision Committee.<sup>534</sup> The objectives of the committee include supervision of financial institutions as well as the promotion of safe, sound and efficient practices by financial intermediaries.<sup>535</sup> The Committee can be said to be the

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<sup>530</sup> CBN Act, 2007 s. 1 (3).

<sup>531</sup> BOFIA, 2004 s.1 provides for the powers, duties and functions of the CBN. See also <http://www.cenbank.org/AboutCBN/> Last accessed 22.3.14

<sup>532</sup> Ibid s.3 and 4

<sup>533</sup> Ibid s.42(1)(b)

<sup>534</sup> Ibid s. 43(1)

<sup>535</sup> Ibid s. 44

supervisory arm of the CBN responsible for regulating banking activities within financial institutions.

One of the duties of the CBN is also to regulate and check the books of banks to make sure they conform to standard practice of banks with a view to determine their financial status. As a result, BOFIA provides that:

‘Every bank shall keep proper books of account with respect to all the transactions of the bank. For the purpose of subsection (1) of this section, proper books of account shall be deemed to be kept with respect to all transactions if such books as are necessary to explain such transactions and give a true and fair view of the state of affairs of a bank are kept by the bank and are in compliance with the accounting standard as may be prescribed for banks. The books of account shall be kept at the principal administrative office of a bank and at the branches of each bank in the English language or any other language approved by the Federal Government’.<sup>536</sup>

The CBN therefore has the power to demand for the books of any bank to determine whether it is in good stead.

In furtherance of the duty to keep proper books, banks are to submit to the CBN a statement showing their assets and liabilities at their head office and branches within and without Nigeria in the form specified by the CBN, from time to time.<sup>537</sup> Also, banks are to submit any other information or documents necessary for the proper understanding of the statements.<sup>538</sup> Such

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<sup>536</sup> Ibid s. 24, *Danson Izedomwen & Ors v Union Bank Plc & Ors* Suit No. FHC/B/290/2009.

<sup>537</sup> Ibid s.25

<sup>538</sup> Ibid s. 25. The section further provides that any bank which fails to comply with any of the requirements of the section is, in respect of each such failure, guilty of an offence and liable to a fine not exceeding N25,000 for each day during which the offence continues.

books must not only be kept, as well as submitted to the CBN, it must be done within a specified time.

Additionally, the Governor of the CBN shall appoint an officer of the CBN who shall be known as the Director of Banking Supervision or by such other title as the Governor may specify. The Director of Banking Supervision has the power to supervise banks, other financial institutions and specialised banks. He also has the power to examine the books and accounts of banks, with access at all times and can require necessary information and documentation from directors, officers and managers.<sup>539</sup>

A major provision of the BOFIA, which becomes paramount for this chapter, is seen in Section 33 and 35 of the Act. Section 33 provides that the governor shall have the power to conduct special examination in a bank where it is necessary in situations where the bank is struggling to cover its liabilities, or where it is carrying out business in a manner detrimental to the interest of the depositors and creditors.<sup>540</sup> Section 35 further provides for the powers of the governor to intervene in a failing bank. A failing bank is described in the Section as an insolvent bank which may be unable to meet its obligations, or a bank which, upon investigation by the CBN pursuant to Section 33 of the Act, is deemed to be in a grave situation.<sup>541</sup> The Section further provides that the governor can, among other things, remove any manager or officer of the bank, notwithstanding any written law or any limitations contained in the Memorandum or Articles of Association of the bank.<sup>542</sup> The implications of the provisions of Section 33 and 35 of BOFIA will be analysed subsequently in detail in the course of this chapter.

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<sup>539</sup> Ibid s. 31

<sup>540</sup> Ibid s.33(1)

<sup>541</sup> Ibid s. 35(1) (a-c)

<sup>542</sup> Ibid s.35 (1(d))

#### ***6.4.1 Arguments for a Unified supervisory role***

Llewellyn (2006)<sup>543</sup> considers major issues associated with organising the institutional structure of financial supervision, including the role of central banks. According to him, unification of banking supervision is necessary due to information-related connections within the banking sector. There is the need for central bank to be directly involved in data and information required in formulation of macro-economic policy and the severance of these functions will not only be expensive but will also lead to duplication in sourcing for information.<sup>544</sup>

Also, the European Central Bank (ECB)<sup>545</sup> posits that central banks in their function of prudential regulation of banks have a mandate for systemic risk and also financial market risk as a whole and it becomes practical that the role of banking supervision and systemic stability be taken by the central bank.

According to Bernanke (2007), because prudential regulation is closely linked to macro-economic policy, as data from the banking sector is very vital for macro-economic policies; both operations should therefore reside in a unified body.<sup>546</sup> Furthermore, information regarding banks liquidity and solvency is very paramount for the central bank, particularly in the performance of its role as a Lender of Last Resort. Another argument in support of a unified regulatory system borders around ability to hire and

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<sup>543</sup> Llewellyn, D.T (2006) 'Institutional Structure of Financial Regulation and Supervision: The Basic Issues' Paper presented at World Bank Seminar – *Aligning Supervisory Structures with Country Needs*

<http://siteresources.worldbank.org/INTTOPCONF6/Resources/2057292-1162909660809/F2FlemmingLlewellyn.pdf> accessed 20 January 2015

<sup>544</sup> Ibid 30

<sup>545</sup> European Central Bank, 'The role of Central Bank in Prudential Supervision' (2001) [www.ecb.int/pub/pdf/other/prudentialsupcbrole\\_en.pdf](http://www.ecb.int/pub/pdf/other/prudentialsupcbrole_en.pdf) accessed 10 January 2015

<sup>546</sup> Bernanke, B.S. (2007) 'Central Banking and Banking Supervision in the US' Speech delivered at Allied Social Sciences Association Meeting, Chicago

train skilled and experienced staff.<sup>547</sup> The central bank in its capacity is able to attract more staff in comparison with an agency with lesser status, especially in an environment where regulators may have to compete to employ qualified and skilled staff.

Furthermore, the independence of the central bank is strengthened with the unification of bank supervision and systemic stability roles and this will also help avoid potential regulatory capture by supervised institutions. According to Davis and Obasi (2009),<sup>548</sup> the need for a single Financial Services Authority empowered with the responsibility of overseeing the activities of the different financial institutions has convinced policymakers worldwide.<sup>549</sup>

Davis and Obasi further enumerate three main areas that determine the level of power needed by the central bank as a supervisory authority, and how this power may be limited or reversed if necessary.<sup>550</sup> Firstly, they note that there is the need for supervisory authority to have corrective powers, which would enable it to take necessary actions where it observes a decline in bank solvency level restructure and reconstruct a bank in extreme cases and also declare a failed bank insolvent.<sup>551</sup>

Secondly, the central bank, as a supervisory authority, should have the power to address issues relating to violations of regulations and legal requirements as well as unethical behaviour by banks. It should be able to do this using its discretion.<sup>552</sup>

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<sup>547</sup> Quintyn, M., & Taylor, M. W. (2003). 'Regulatory and supervisory independence and financial stability' 49(2) *CES ifo Economic Studies*, 259-294.

<sup>548</sup> Davis, E.P., Obasi U. (2007) 'The Effectiveness of Banking Supervision' *Brunel University Economic and Finance Working Paper Series*, Working Paper 09-27 [http://www.brunel.ac.uk/\\_data/assets/pdf\\_file/0020/82118/0927.pdf](http://www.brunel.ac.uk/_data/assets/pdf_file/0020/82118/0927.pdf) accessed 22 January 2015

<sup>549</sup> Ibid 6

<sup>550</sup> Ibid

<sup>551</sup> Ibid

<sup>552</sup> Ibid

Lastly, there should be no interference from the courts in the exercise of the central bank's function as a supervisory body. The court should serve as a complement to the central bank and not undermine or overrule its actions unreasonably.<sup>553</sup> Going by this, it is important that there exists a balance of power firstly between the central bank in its supervisory capacity and the institutions which they supervise, and secondly between the courts and the central bank.

In contrast to the above, Quintyn and Taylor are of the view that such authority may become too powerful to the detriment of the financial system or suffer diseconomies of scale where multiple supervisory authorities supervise financial institutions.<sup>554</sup> Furthermore, Quintyn and Taylor suggest the independence of bank supervisors from politicians, the banks they supervise and unreasonable termination of office.<sup>555</sup> In effect, the level of their independence is related to the entire standards of governance and accountability in the country.<sup>556</sup>

#### ***6.4.2 Arguments for Separation of Banking Supervision and Monetary Policy***

One of the main arguments in support of separation of banking supervision lies in the issue of conflict of interest. This is premised on the fact that supervisory concerns on the banking system may influence the central bank to be more accommodating in relation to monetary policy than necessary for maintaining price stability.<sup>557</sup> This argument is also rooted in the risk of credibility and reputational loss that is associated with the sole responsibility of supervision. This, according to Goodhart, is because on the one hand, scholars of economic and monetary analysis stress the need to be

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<sup>553</sup> Ibid

<sup>554</sup> Quintyn, M., and M.W.Taylor, (n. 534)

<sup>555</sup> Ibid

<sup>556</sup> Davis and Obasi Ibid 6 Independence of the CBN will be analysed subsequently.

<sup>557</sup> ECB, The Role of Central Bank in Prudential Supervision, (2001) 5-6



able to influence expectations while central bank practitioners stress the importance of credibility.<sup>558</sup> The central bank may therefore accommodate bail-out pressures through the use of liquidity measures (in the form of Lender of Last Resort, Open Market Operations) in a bid to avoid reputational loss that may jeopardize the credibility of the Central Bank as a monetary authority.<sup>559</sup>

Also, as a regulator, financial performance and economic stability of banks and the financial sector as a whole becomes paramount to the Central bank, and in performing this role, there is the tendency that their reputation be put to question because owing to the fact that economic stability is very vital to the Central bank, various monetary strategies could be put in place which may be quite flexible, therefore posing issues of credibility upon the bank. Due to the vital nature of credibility and reputation, especially in ensuring price stability in the economy, perhaps it is better that the Central bank stay clear of bank supervision.

Furthermore, Goodhart views the role of supervision as a thankless task which may tarnish the image of the supervisor. Supervision is mainly premised on preventing undesirable events and financial distress and a supervisor is basically noticed when supervision fails or when he takes a restrictive action against the regulator.<sup>560</sup> This is usually the case where problems of mismanagement and financial crisis take place. For instance in the case of the Nigerian banking crisis of 2009 (the subject matter of this research), it can be said that before 2009, the positive activities of the CBN to regulate the banking and financial sector in general were unnoticed by the general public; however, upon the actions of the CBN, sacking the five directors in 2009 owing to allegations of control fraud and financial

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<sup>558</sup> Goodhart (n.529) 20

<sup>559</sup> Pellegrina, L. D, Masciandaro, D., Pansini, R. V. (2013). 'The central banker as prudential supervisor: Does independence matter?' 9(3)*Journal of Financial Stability*,415. 418. See also ECB, The Role of Central Bank in Prudential Supervision, (2001) 6

<sup>560</sup> Goodhart Ibid. 20

mismanagement, there was a public outcry on the inability of the CBN in the conduct of its supervisory role of regulating these banks. The public was quick to criticise the activities of the CBN both generally and around the time of the crisis.

Going further on the need for separation of banking supervision, Jacome<sup>561</sup> is of the opinion that the unification of banking supervision to the Central bank will grant the bank the sole discretion of ‘monetising’ financial distress.<sup>562</sup> This is a situation whereby the decision for financial bail-out becomes the responsibility of the bank; and in a situation where there is a potential risk of collapse of the entire financial system,<sup>563</sup> the bank may be quick to fuel such risk in order to avoid the ultimate bail-out of the system that could ultimately lead to financial instability.

Although in order that the Central bank exercise its powers appropriately in supervision of the financial system, it is important that it is independent from adverse influence. The problem, however, lies in identifying exactly how much power the Central bank has and how this is used. Eijffinger and Hann<sup>564</sup> posit that it is difficult to measure the degree of independence that Central banks have, let alone the extent to which this independence is free from political influence. Actual independence as opposed to legal independence is restricted to individual countries and most research generally tends to focus on actual independence. In Nigeria, the independence and accountability of the CBN is not only dependent on the enabling Act or legislation, but a function of a collection of other unquantifiable factors such as the calibre of bank officials and key personnel of the bank, as well as informal political arrangements with the government.

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<sup>561</sup> Jacome, L. I. (2008). Central bank involvement in banking crises in Latin America. *IMF Working Papers*, 1-49.

<sup>562</sup> This is done through bail out measures such as Open Market Operations, Lender of Last Resort, etc

<sup>563</sup> Also known as systemic risk

<sup>564</sup> Eijffinger, S.C.W., De Haan, J. (1996) ‘The Political Economy of Central Bank Independence *Special Papers in International Economics* (19 May 1996) 22

The problem of excessive power in a system where accountability measures are weak may lead to abuse of power by the Central bank and this may pose potential risk where such powers are concentrated in the hands of un-elected officials.<sup>565</sup>

In summary that in a country with an under-developed economy such as Nigeria where corruption is also endemic, it is probable that the CBN cannot be truly independent. A good suggestion therefore will be to adopt the position of Goodhart and to separate both roles by means of legislation.

### **6.5 CBN's Lender of Last Resort policy**

In the last decade, the Central bank's liquidity assistance to failing loans in banks has prompted issues on the topic of Lender of Last Resort (LOLR). According to Bordo<sup>566</sup>, the classical doctrine of LOLR arises from banking panic in a fractional reserve banking system. Bordo describes banking panic as 'a widespread attempt by the public to convert deposits into currency; and in response, an attempt by commercial banks to raise their desired reserved-deposit ratios'.<sup>567</sup> Banking panic occurs when a series of failures occur within a short while that could threaten the solvency of otherwise sound banks.<sup>568</sup> It is pertinent to mention that bank failures can be necessitated by two factors – internal and external. Internal factors include both financial and non-financial factors, including control fraud and financial mismanagement. External factors refer to adverse changes in the overall prices of assets, which may have an adverse effect in the value of the bank's portfolio, thereby rendering it insolvent. Control fraud can therefore be said to be a notable example of failure that could impact on the future of

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<sup>565</sup> Masciandaro, D (2006) 'E Pluribus Unum? Authorities Design in Financial Supervision: Trends and Determinants' 17(1) *Open Economies Review*,73-102

<sup>566</sup> Bordo, M.D. (1990) 'Lender of Last Resort, Alternative views and Historical Experience' *Economic Review*18-29

[http://www.rich.frb.org/publications/research/economic\\_review/1990/pdf/er760103.pdf](http://www.rich.frb.org/publications/research/economic_review/1990/pdf/er760103.pdf)

accessed 23 March 2013

<sup>567</sup> Ibid 18

<sup>568</sup> Ibid

sound banks. It can therefore be said that ultimate aim of the CBN's Lender of Last Resort role is to serve as a pacifier of the incipient panic to be created by control fraud through provision of high-powered money, either through Open Market Operations or through the discount window.<sup>569</sup>

Furthermore, depositors may find it hard to distinguish a sound from an unsound bank, especially where there is a panic in the banking system. This may then lead to bank runs whereby depositors withdraw their deposits simultaneously due to concerns that the bank may be insolvent. Runs on insolvent banks can lead to runs on solvent banks due to panic. Sound banks are therefore made insolvent by the fall in the value of their assets owing to the struggles for liquidity as they have to engage in 'fire sales'<sup>570</sup> of assets to meet demand for cash; this in turn drives down asset prices, endangering other previously solvent banks. At a point where the liquidity of solvent banks is threatened, intervention by a Lender of Last Resort will serve to allay the panic. Scholars have argued for and against Central bank as a Lender of Last Resort.

To start with, Goodhart examines Central bank as a Lender of Last Resort (LOLR) to insolvent banks. According to him, although the traditional trend of LOLR is to lend freely but at a penalty rate to illiquid but solvent banks, the difference between illiquidity and insolvency remains unclear. This is so because many banks that require LOLR due to illiquidity are already under suspicion with regards to solvency.<sup>571</sup> Furthermore, at the time when the bank is faced with illiquidity, it may be difficult for the Central bank to evaluate the assets of the distressed bank within the space of time involved; it will therefore have to take an immediate decision to provide last resort facilities when it knows that there may be a solvency problem, but just

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<sup>569</sup> Ibid

<sup>570</sup> This is a situation whereby goods and assets are sold at discounted prices after being heavily reduced.

<sup>571</sup> Goodhart, C. (1988). *The Evolution of Central Banks*. London: MIT Press Books; Goodhart, C. A. E. (1987) 'Why Do Banks Need a Central Bank?' 39 *Oxford Economic Papers* 75-89.

doesn't know its full extent.<sup>572</sup> He also argues that the valuable customer-bank relationship between depositors and the bank becomes severed in the case of bank run on an insolvent bank. Goodhart therefore concludes that in order to avoid loss of this relationship and in a bid to protect borrowers, LOLR becomes necessary.

Solow also argues that since the Central bank is responsible for the stability of the financial system, bank failures would have a large impact on the financial system of the economy, mainly in the loss of confidence (and lack of investment); it is therefore necessary that it provides financial assistance to insolvent banks and restores stability to the financial system. However, Bordo considers this to be a moral hazard due to higher risk-taking, with the public losing incentives to monitor them.<sup>573</sup>

Writers against LOLR have argued that banking panic is a mere reaction to the legal restrictions on banking in each legal system, the absence of which would lead to a panic-proof free market and where depositors are adequately informed of the situation of their banks, simultaneous runs will not occur.<sup>574</sup>

### ***6.5.1 CBN Lender of Last Resort and the Discount Window***

The role of the CBN in granting loans through the discount window is pivotal to this research. This is because the use of the discount window has been revealed as a central means through which control fraud was perpetrated in the banks. It is therefore important to examine the role of the CBN regarding discount window operations in order to explore how internal regulatory weakness of the CBN might have facilitated control fraud.

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<sup>572</sup> Goodhart (1988) Ibid 35

<sup>573</sup> Bordo (n.611) 21

<sup>574</sup> Gorton, G. (1985). 'Clearing houses and the Origins of Central Banking in the U.S.' 45 *Journal of Economic History*, 277-84; Gorton, G. and D. J. Mullineaux (1987) 'Joint Production of Confidence: Endogenous Regulation and 19th Century Commercial Bank Clearinghouses.' 19(4) *Journal of Money, Credit and Banking* 457-68.

In Nigeria, the Central bank's Lender of Last Resort role is provided in Section 42 (2) of the CBN Act to the effect that the bank may grant loans together with other accommodation facilities at set rates of interest and terms as determined to any bank which may be having liquidity problems. It is important to mention that the CBN Act fails to define the term 'liquidity'. However, liquidity can be considered in three possible definitions.<sup>575</sup> Firstly, in terms of financial instruments, liquidity refers to the ability with which they can be exchanged without loss of value. Secondly, market liquidity refers to the ability of the market to trade large quantities of assets and securities quickly at a low cost without necessarily affecting the price.<sup>576</sup> Monetary liquidity, which is the third possible definition for liquidity, reflects to the quantity of liquid assets circulating in the economy, measured by monetary aggregate or its GDP ratio.<sup>577</sup>

As a bank of all banks, the LOLR role of the CBN is attached to the mandate of ensuring financial stability in the country. It is important to mention at this stage that the CBN Act does not explicitly provide the criteria for granting loans to banks and the ratio for calculation of the penalty rate of these loans. However, this is provided for in the CBN Guidelines on the Expanded Discount Window Operations of 2008.<sup>578</sup> Mention must be made that the Discount Window was expanded in 2008 following the global financial crisis and also liberalization of the financial markets. The expansion in itself involves the admittance of non-federal

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<sup>575</sup> Financial Stability Directorate (2008) 'Liquidity in the time of Financial Turbulences' 11 *Banque de France Financial Stability Review* 1.

[https://www.banque-france.fr/fileadmin/user\\_upload/banque\\_de\\_france/publications/Revue\\_de\\_la\\_stabilite\\_financiere/ve\\_0208.pdf](https://www.banque-france.fr/fileadmin/user_upload/banque_de_france/publications/Revue_de_la_stabilite_financiere/ve_0208.pdf) accessed 22 January 2015

<sup>576</sup> See also Pastor, L., & Stambaugh, R. F. (2001). 'Liquidity Risk and Expected Stock Returns' *National Bureau of Economic Research* 1

<http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.407.8237&rep=rep1&type=pdf> accessed 21 January 2015

<sup>577</sup> Financial Stability Directorate (2008) Ibid

<sup>578</sup> CBN Guidelines on the Expanded Discount Window Operations, October 2008. <http://www.cenbank.org/OUT/CIRCULARS/BOD/2008/CIRCULAR%20AND%20GUIDELINES%20ON%20THE%20EXPANDED%20DISCOUNT%20WINDOW.PDF> accessed 13 March 2014

government instruments and the extension of the tenure of liquidity period to 360 days.<sup>579</sup>

According to the Guidelines, Discount Window is defined as the medium through which the CBN grants credits to Deposit Money Banks (DMBs)<sup>580</sup> and Discount Houses (DHs) at the Discount Window (DW).<sup>581</sup>

There are two types of credit facilities available to eligible borrowers. These are Standing Lending Facility and Fixed Tenure Repurchase agreement as provided for in S.26 of the Guidelines. Standing lending facility, also known as outright borrowing, is an overnight advance available to DMBs and DHs. The collateral for this facility is set at ten per cent for Federal Government backed Securities above the value of the amount applied for and in all other cases, the bank has the right to set the collateral margin. Section 27 further sets out the procedure for applying for Standing Lending Facility.

Repurchase Agreement on the other hand is the immediate sale of securities for payment followed by a recommitment to buy same on a later date and at a fixed term (usually not exceeding 360 days).<sup>582</sup> It therefore involves two simultaneous agreements in one contract.<sup>583</sup> Section 30 further provides that a Repurchase Agreement could either be a buy-back (Repo) or a sell-back (Reverse) depending on the standpoint of the borrower or lender. However, the CBN will view a transaction as a Repo for the purposes of the Discount Window. A Repo is viewed as a loan and therefore the applicable rate is set by the market. Also the maximum amount borrowable under a Repo is usually within 70 per cent of the face value of the eligible security. Eligible instruments that can be used for collateral includes: Nigerian Treasury bills, Treasury Certificates, Federal Government Bonds, NDIC Accommodation

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<sup>579</sup> Ibid s.1

<sup>580</sup> It is important to note that the five banks used in this thesis falls under the category of Deposit Money Banks (DMBs)

<sup>581</sup> Ibid s.3

<sup>582</sup> Ibid s.32(1)

<sup>583</sup> Ibid s.29

Bills, State Government Bonds, Guaranteed Commercial Papers or Promissory Notes, and any other instruments that may be approved by the bank from time to time.<sup>584</sup>

Section 4 of the Guidelines states the conditions for the operation and function of the Discount Window. These are listed below:

1. Lender of Last Resort Facility - Institutions seeking to utilize the DW must first fully exhaust all alternative market sources. The DW is to be approached on a Last resort basis only.
2. Deposit Money Banks and Discount Houses shall access the DW only on a secured basis. Any credit must therefore be fully and adequately collateralized by eligible securities.
3. Deposit Money Banks and Discount Houses may use the DW to obtain liquidity from the Bank via repo or collateralized loans against eligible instruments.
4. Repo credit from the DW shall be for a period not exceeding one year.
5. Collateralized loans shall be on an overnight basis through standing lending facilities.
6. Credits at the DW must be with eligible instruments whose tenure shall not exceed one year. In other words, such instruments shall be those qualifying for secondary market operations with the Bank.
7. Credits by way of an advance or outright borrowing must be fully secured by eligible instruments.
8. The eligible instruments at the DW will be rated appropriately and in line with the prevailing economic conditions and the financial well-being of the issuer of the security.
9. Advances or outright borrowing at the DW, whilst adequately secured, shall be priced appropriately, and the applicable rate of interest will be governed by the prevailing economic and market conditions. In any

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<sup>584</sup> See generally Section 6-24 of the Guidelines



event, such advances shall attract a rate of interest at the Bank's MPR plus a margin determined at the discretion of the Bank.

All DMBs and DHs have direct access to the Discount Window. However, the CBN has the power in exercising its discretion on access to the window and this may be denied in the following circumstances:<sup>585</sup>

- If the Bank observes an act of undue rate arbitrage in the operations of the institution's dealings;
- If an institution is found to have contravened the provisions of the Bank's monetary and credit policy guidelines;
- If the Bank discovers that the institution has been over-trading or engaged in undue mismatch of its assets and liabilities;
- If there is contravention of the clearing houses rules;
- If there is any contravention or non-observance of provisions of the prudential guidelines;
- If a DMB/DH under a holding action fails to comply with the provisions of the holding action.

From the above provisions, it can be said that the CBN is fully empowered to provide access to the Discount Window as a Lender of Last Resort and in allaying liquidity shortages and absorbing excess liquidity that could arise in the banking system. However, as Goodhart points out, the distinction between liquidity and insolvency is far from clear; an illiquid bank can become insolvent and vice versa.<sup>586</sup>

It is important to mention that in the case of the five banks, access to the discount window must have been provided based on collateralized loans against eligible instruments as provided for in the CBN guidelines discussed above. It is however unclear, what instruments were actually provided as

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<sup>585</sup> Ibid s.5

<sup>586</sup> Goodhart, C. (2008) 'Liquidity risk management.' 11 *Banque de France Financial Stability Review* 39-44.

collateral for these loans. Perhaps the publishing of the list of non-performing loans granted by these banks suggests that they might have been used as collaterals for the persistent access to the discount window; however, whether or not this was actually the case remains unclear and the CBN has remained silent on this. This calls for attention regarding accountability of the CBN.

## **6.6 The role of the CBN during the Banking Crisis of 2009**

In 2004, the Central Bank launched a financial strategy of raising the minimum share capital of banks to N25billion (\$167million), as a reform strategy to adhere to changing phases in international corporate governance.<sup>587</sup>

The consolidation exercise seemed a perfect solution for the CBN at the time. However, on the 3<sup>rd</sup> of June 2009, Lamido Sanusi was appointed by the president to replace Charles Soludo. However, within a few months of his assumption into office, precisely on the 14<sup>th</sup> of August 2009, the new CBN governor, upon investigation of five of the registered banks which led to the discovery of financial distress owing to fraudulent practices and mismanagement of funds, fired the CEOs and Board of Directors of five banks in Nigeria in accordance with Sections 33 and 35 of BOFIA 2004, replacing them with CBN appointed CEOs and Board of Directors.<sup>588</sup> The banks involved include: Afribank Plc, Intercontinental Bank Plc, Union Bank of Nigeria Plc, Oceanic Bank International Plc and Finbank Plc.

According to Sanusi:

‘Available results from the tests showed that the five banks had aggregate non-performing loan portfolios of

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<sup>587</sup> Details of this has been provided in Chapter Three.

<sup>588</sup> See ‘Address by the Central Bank of Nigeria on developments in the banking system’. Available at [www.cenbank.org/documents/speeches.asp](http://www.cenbank.org/documents/speeches.asp) accessed 22 March 2014

40.8% and accounted for a significant proportion of total bank exposure to the stock market and oil and gas sector. Again, the banks accounted for 39.93% of total sector loans, 29.99% of deposits and 31.47% of total assets as at the 31st of May 2009.<sup>589</sup>

Clearly, under Section 33 of BOFIA explained earlier, the CBN has the power to conduct special examination of the affairs of the bank where necessary. The CBN is also empowered to sack and replace the CEOs under Section 35 of the BOFIA.

On October 2, 2009, barely 48 days later, the CBN governor sacked additional CEOs and board of directors of three further banks, replacing them with CBN appointed CEOs and boards. This increased the total number of affected banks from 5 to 8. The three banks involved were Platinum and Habib Bank (popularly known as Bank PHB), Spring Bank and Equatorial Trust Bank (ETB).<sup>590</sup> The CBN then declared intervention in the distressed banks in order to prevent their collapse by injecting a total of N420billion (\$2.8million) liquidity into the banking system in the form of unsecured and subordinated debt and also the provision of a guarantee of all interbank lending transactions, foreign credit lines and pension deposits. The CBN relied on the provisions of Section 33 and 35 of BOFIA for its action.<sup>591</sup>

While the Section does not state that the Governor can expressly inject money into the banks, it provides that the Governor after an examination of these banks can make an order to prohibit any further credit facility to the banks (such as the EDW), and most importantly, the Governor can require the bank to take any steps in relation to its business as considered necessary. The CBN claimed it based its actions on the provisions of Sections 33 and

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<sup>589</sup> Ibid

<sup>590</sup> Ibid

<sup>591</sup> BOFIA, 2004, s.35(1)(d), (2)(a, b, d)

35 to the effect that it can remove and replace the directors after conducting its investigations and it can also take necessary steps as required in the banks.

Furthermore, the governor in an address highlighted the following factors as its reason for intervention:<sup>592</sup>

- The affected banks constituted a systemic threat to the financial sector in Nigeria due to their operational failure.
- The affected banks lacked sound risk management processes.
- The absence of corporate governance regimes and practices in the affected banks.
- The prevalence of unethical practices by the management of the affected banks including huge amounts of non-performing loans.

#### ***6.6.1 The regulatory involvement of CBN in Afribank***

In 2012, the House of Representatives, through a resolution, set up an ad hoc committee to investigate the near collapse of the Nigerian Capital Market through public hearing and explore the factors that led to the near collapse of the capital market in order to find possible solutions to the problem.<sup>593</sup> In order to achieve its objectives, the ad hoc committee conducted inquiries into activities of regulators, operators, persons or institutions that were connected with the capital market from 1999 to date.

It is important to mention that the committee specifically stated that while adequate cooperation was received from stakeholders, certain Government

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<sup>592</sup> Sanusi Lamido Sanusi ‘Address by the Governor of the Central bank of Nigeria, on Developments in the Banking System in Nigeria’ <http://www.cenbank.org/Out/speeches/2009/Govadd-14-8-09.pdf> accessed 12 October, 2014 (This was elaborated in detail in Chapter four).

<sup>593</sup> Report of the Ad-Hoc Committee on the Investigation into the Near Collapse of the Nigerian Capital Market, National Assembly, Abuja, Resolution No. (HR70/2012)17. P. 6 <http://proshareng.com/news/download.php?item=AdHocCommitteeonCapMktReport19%25200712.pdf> accessed 12 October 2014

agencies, namely CBN, SEC and AMCON, refused to cooperate with the committee and failed to divulge relevant documents considered very vital to the investigation.<sup>594</sup> During the investigation by the Ad Hoc Committee of House of Representatives, Sebastine Adigwe, former Managing Director/Chief Executive Officer of Afribank Plc, stated that the collapse of the banking sector was as a result of CBN's regulatory intervention which caused remaining international players to pull out their money. Again, CBN pressure on banks to recover loans, led to over N1 trillion of banks' fund trapped in the capital market; CBN expropriation of investors shares by forceful takeover and change of business name in an arbitrary process thereby discouraging further interest of foreign and local investors; CBN as the regulator, was unable to propose and implement a timely and carefully planned bail-out option.<sup>595</sup>

Further indictment on the CBN before the Committee was that in August 14, 2009 the CBN sacked the executive directors of the bank, basing their decision on the fact that Afribank had a liquidity ratio of 24 per cent against CBN's prescribed ration of 25 per cent; capital adequacy ratio of 8.49 against CBN's prescribed 10 and corporate governance violations such as mismanagement and weak internal controls. Prior to that, the CBN had earlier approved N70billion to be raised through bond issues but this was truncated following the intervention; subsequently, the CBN injected N50billion into the bank (through unsecured and subordinated debt and also the provision of a guarantee of all interbank lending transactions, foreign credit lines and pension deposits); an action that affected risk assets and compounded the crisis.<sup>596</sup>

The Committee further revealed that one of the major causes of the capital market downturn is sudden change of policies, poorly thought-through

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<sup>594</sup> Ibid

<sup>595</sup> Ibid

<sup>596</sup> Ibid, 18.

tightening of regulations and a scapegoat approach to a systemic problem by the new CBN administration.<sup>597</sup> In the case of Afribank, it was revealed that the CBNs' appointed managers in Afribank, classified all risk assets as lost, and therefore created a liquidity scenario during the sale of the bank in 2010. The CBN initially shortlisted 2 bidders: Vine Capital Limited and Fidelity Bank PLC. Based on this, Afribank signed a memorandum of understanding (MOU) with Vine capital, however, CBN in the exercise of its powers and policies rejected the bid. Subsequently, Afribank's license was withdrawn and the assets and liabilities of the bank transferred to Asset Management Committee of Nigeria (AMCON) and the name changed to Mainstreet Bank Ltd, a private company.<sup>598</sup>

In the memorandum provided to the AdHoc committee, the CBN listed the causes of the banking crisis such as Macroeconomic instability; major failures in corporate governance risk management; lack of investor and consumer sophistication; poor disclosure and transparency; gaps in regulatory framework; weaknesses in business environment.<sup>599</sup> However, it must be noted that till date, the CBN is yet to respond to the following issues raised during the investigation by the Ad Hoc Committee:

- The Special Examination report with respect to the 10 banks, and the 8 intervened banks, and all the accompanying approvals, Board Resolutions, and all other relevant explanatory details;
- Bank-by-bank analysis of movements/trends in margin loans balances 2006 to date;
- schedule of Capital Verification Report following the banking sector consolidation of 2004/2005;

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<sup>597</sup> Ibid

<sup>598</sup> Assets Management Corporation of Nigeria (AMCON). Set up in 2010 by the Nigerian President. The corporation is charged with the responsibility of revitalizing the financial system by helping to resolve the non-performing loan assets of banks. See [http://www.amcon.com.ng/about\\_us.aspx](http://www.amcon.com.ng/about_us.aspx) Last accessed 12.01.14

<sup>599</sup> Ibid 37.

- a schedule showing the forbearances, waivers, or other financial accommodation granted to any bank or groups of bank on account of the banking sector consolidation of 2004/2005;
- schedule of all liquidity injections into the banking system from the onset of the banking consolidation of 2004 up to the period to April 31st, 2012;
- details of the commercial banks' exposure to the CBN discount and expanded discount window, on a bank-by-bank basis from the year 2004 to the period to 31st April, 2012;
- schedule showing CBN'S approval of bad loans assumed by AMCON from the period of AMCON's inception to date;
- CBN's Analytical Balance Sheet for the period 2004 to 2008, then, 2009 to the period to 31st April, 2012; Details of share exchange computation by AMCON representing the share values of shareholders in all the intervened banks;
- Evidence that the CBN have received the sum of N620billion, claimed to have been repaid.
- Status Report on Savanna Bank PLC, SGBN, showing details of all assets and liabilities due to investors and shareholders as accounted for by the Nigerian Deposit Insurance Corporation.<sup>600</sup>

It is important to reiterate that accountability of the CBN remains of major concern, particularly in its refusal to respond to the demands of the committee. It follows that this issue must be dealt with for future control frauds to be prevented in Nigerian banks. It is important that every actor plays its role in corporate governance regulation and failure to publish publicly relevant data is not quite encouraging in towards preventing future control frauds in Nigerian banks.

The following conclusions were made by the committee:

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<sup>600</sup> Ibid 38.

Firstly, the circumstances and the processes surrounding the three nationalised banks of August 5th, 2011, in Nigeria, remain a major source of investors' loss of confidence in the Nigerian capital market. By August 2009, CBN intervened in 10 banks; however, it gave the intervened banks up to September 30th 2011, to recapitalise. But, between Friday 5th August 2011 to Monday, 8<sup>th</sup> August, 2011, without any further warning, the licenses of three banks, namely, Afrikanbank PLC, Spring Bank PLC, and Bank PHB, were revoked by the CBN; and Nigerians and investors were informed that the names of these banks have been changed as follows: Afrikanbank PLC, now to be known as Mainstreet Bank; Bank PHB, now to be known as Keystone Bank; and Spring Bank PLC, now to be known as Enterprise Bank.<sup>601</sup>

Secondly, the CBN Governor withheld all material information, financial records, schedules, reports, and Minutes of all Board Meetings, and in all cases, particularly the CBN's refusal to produce the Special Examination Report preceding its intervention in the 10 banks in August 2009. The CBN had stated that the Reports, among many others which the Committee requested, were purely confidential to it alone. The CBN, by this act, prevented the Ad Hoc Committee from independently verifying the rationale for the cash injections into the banking sector by the CBN. Furthermore, the Ad Hoc Committee was unable to reassure itself that the injected funds were not just a mere attempt for the money to find its way into the foreign exchange market, and/or, the capital market.<sup>602</sup>

Furthermore, the Governor rebuffed all amicable letters sent to him to send the required documents that the Committee needed. The Committee issued a 24 hours ultimatum to the CBN Governor, after the expiration of the enrolled Order, but the CBN replied that it has no reply as the entire Board

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<sup>601</sup> Ibid 42

<sup>602</sup> Ibid 47-48



and the Governor had been in a Retreat in South Africa!<sup>603</sup> The requested documents have not been produced to date.<sup>604</sup>

Following from the above, the CBN may be said to be in breach of the provisions of the Section 12(2) Freedom of Information Act.<sup>605</sup> The section provides that an application for the disclosure of information is not to be refused where the public interest in disclosing the information outweighs whatever injury that disclosure will cause.<sup>606</sup> In confirming this position, the court, in the case of *Mr. Boniface Okezie v The Central Bank of Nigeria*,<sup>607</sup> stated that there exists strong and compelling public interest for the CBN to disclose the relevant information, as this will shed more light in its expenditure of public funds and and provide the tax-paying public with better view of the self-styled banking reform programme embarked upon by the CBN governor, and this interest outweighs the concerns of the Governor. From this case, the CBN through its Governor, failed to disclose to Mr. Okezie, which breaches the provisions of the FOI Act.

### **6.6.2 The regulatory involvement of CBN in Union Bank**

The case of Union bank remains the only decided case in relation to the activities of the CBN during the crisis and therefore becomes vital. The case of *Danson Izedomwen & Ors v. Union Bank Plc & Ors*<sup>608</sup> is premised upon the CBN's investigation of the affairs of the activities of Union bank and subsequent removal of the executive directors and appointment of replacements pursuant to Section 33, 35 and 36 of BOFIA. Aggrieved by the situation, some shareholders of the bank instituted an action against the

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<sup>603</sup> Ibid 47

<sup>604</sup> Ibid 48

<sup>605</sup> The Freedom of Information (FOI) Act, 2011. Available at <http://www.nigeria-law.org/Legislation/LFN/2011/Freedom%20of%20Information%20Act.pdf> accessed 22 December 2014

<sup>606</sup> FOI Act, 2011 s.12(2)

<sup>607</sup> Suit No. FHC/L/CS/494/2012.

<sup>608</sup> Suit No. FHC/B/290/2009, Judgment Delivered on October 25<sup>th</sup> 2010

CBN, arguing that upon proper construction of the Act, it would be seen that the governor had acted *ultra vires* as the law only conferred power on the Governor to:

- (a) Remove only one director at any given time,
- (b) Either remove, or appoint a director, but not both,
- (c) The Governor lacked powers to allocate specific functions to the directors he appoints, and
- (d) The actions of the Governor were in breach of the memorandum and articles of association of the Bank.<sup>609</sup>

Reaffirming the governor's powers, the court held that it is vital that a statute be construed according to its expressed intention and the words are to be understood by looking at the issue. The court also held that the governor is empowered to exercise one or more of the powers specified in Section 35 of the Act, and the use of the word 'any' means that the governor is not restricted to exercising only one of the powers specified in Section 35(2) which allows for removal of directors, appointment of new ones, capital injection, etc; but could exercise some or all of the powers. Relying on the decision in *Ndoma V Chukwuogor*<sup>610</sup>, the court held that the word 'or' in the Section 35(2) should be given a conjunctive meaning. The court also agreed that by Section 35(2)(d) of the Act, the powers of the governor are exercisable '*notwithstanding any written law*' and by also referring to the decision of the Supreme court in *NDIC V. Oken Enterprises Ltd*<sup>611</sup> the court also held that the word 'Notwithstanding' '*exclude an impinging or*

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<sup>609</sup> FOI Act, 2011 s.35(2)

<sup>610</sup> [2004] All FWLR [Pt 217] 735

<sup>611</sup> (2004) 4SC [PT 11] 77

*impending effect of any other provision of the statute or subordinate legislation so that the said section may fulfil itself.*"<sup>612</sup>

Finally the court held that he who has power to appoint has power to fire, even when the general rule is silent on the power to remove. Referring to Section 11(1) of the Interpretation Act, 2004 which provide that where a provision empowers a person the power to appoint, whether to an office or to exercise any functions, whether for a specified period or not, the power also includes the power to remove or suspend him.

It becomes clear from the above judgment that the powers of the CBN and its actions in relation to the failing banks in 2009 have received judicial *imprimatur*. It remains to be seen if other cases involving the CBN and its activities during the crisis will be decided in the same line and what the reaction of the Appeal court will be.

## **6.7 Factors responsible for the CBN'S role in the Banking crisis**

### **6.7.1 Institutional Factors**

In 2010, the CBN, in an address on the impact of the global financial crisis in Nigeria which was presented to the House Financial Services Committee of the US Congress Hearing on the global financial crisis, addressed major reasons attributed to the CBN in the periods leading to the crisis.<sup>613</sup> One of the reasons stated by the CBN was the absence of co-ordination among regulatory institutions in the banking sector, including the CBN.<sup>614</sup>

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<sup>612</sup> Ibid

<sup>613</sup> Sanusi L. Sanusi, 'Global Financial Crisis Impact in Nigeria, Nigerian Financial Reforms and the Roles of Multilateral Development Banks and IMF' Submission to the House Financial Services Committee of the US Congress Hearing on the Global Financial Crisis, 2010:

<<http://financialservices.house.gov/media/file/hearings/111/sanusi111610.pdf>> accessed 12 January 2014.

<sup>614</sup> Ibid 11-12

According to the CBN, the lack of co-ordination prevented the CBN from having a comprehensive consolidated bank view of the activities of these banks. For instance, the Financial Services Regulatory Coordinating Committee (FSRCC), the body responsible for co-ordinating financial regulators, had not for two years during this period. Although excess capital is meant to increase lending, it was discovered that banks were also using the capital for a number of non-lending activities including stock market investments, which were mostly diverted to subsidiaries abroad, thereby, escaping the supervisory authority of the CBN.<sup>615</sup>

Also, SEC produced no examination reports for subsidiaries, neither was there a mechanism for consolidated bank examination.<sup>616</sup> Sanusi went on to state that lack of adequate corporate regime also contributed to the crisis, For instance, there was no legal and regulatory framework governing the margin lending activity.<sup>617</sup>

Another important contributory factor was uneven supervision and inadequate enforcement.<sup>618</sup> Sanusi identified enforcement failure as the biggest problem of the crisis. According to Sanusi, regulators were ineffective in foreseeing, anticipating and supervising the changing phase in the industry or addressing the prevalent corporate governance failures such as granting of unsecured loans. For example, the Supervision Department within the CBN was not structured to supervise effectively and to enforce regulation; therefore, no one could be held accountable for failure to address issues such as risk management, corporate governance, fraud, cross-regulatory co-ordination, money laundering, enforcement and the likes.<sup>619</sup>

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<sup>615</sup> Ibid

<sup>616</sup> Ibid. 12

<sup>617</sup> Ibid 11-12

<sup>618</sup> Ibid 12

<sup>619</sup> Ibid

Furthermore, while some examinations identified critical risk management issues, the examination failed to reveal many issues that caused the crisis, even though they were known in the industry. Time was also a contributory factor and many examinations took between 9 months to a year to complete.<sup>620</sup> The CBN also identified the fact that financial penalties available at the time were not adequate measures of compliance. Because banks could get away simply with the payment of fines, they practically annulled relevant aspects of examination reports.<sup>621</sup>

Also, records on compliance of banks were poor. There was inadequate discipline in committing banks to respond to examination reports and recommendations were frequently ignored, despite the gravity of issues specified.<sup>622</sup> This is due to the fact that the penalty prescribed for non-compliance was not enough to change their behaviour as directors faced no personal liabilities for non-compliance.<sup>623</sup>

The policies of CBN have also impacted on the bank crisis in Nigeria. It is true that the banking consolidation was initiated during Joseph Sanusi's era as CBN Governor, which was to be done in phases. But the Chukwuma Soludo-led board of the CBN decided to alter this approach, insisting on a one-time share capital increase to N25billion. Although the CBN did a verification exercise for the first round of capital-raising, the time-consuming exercise was criticised by foreign investors, and it was later discontinued. This led to unintended consequences, which negatively affected the financial sector, and unfortunately the CBN turned around to accuse the banks of buying their own shares with depositors' money and

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<sup>620</sup> Ibid

<sup>621</sup> Ibid

<sup>622</sup> Ibid 13

<sup>623</sup> Ibid

that the resultant decrease in share price has led to a serious impairment on the banks' shareholders fund.<sup>624</sup>

### **6.7.2 Political Factors**

Furthermore, Nigerian banks have to some extent remained dependent on the government in two broad ways, *to wit*, as a client and as a provider of capital in times of distress. Nigerian banks tend to rely on the government as a client due to the fact that they are required to hold many of their assets in the form of liquid, low-risk assets, such as government securities.<sup>625</sup> As seen in the previous chapter, most of the banks had as their majority shareholders, Nigeria's social and political elites and retired military officers. Due to this, the CBN might have been handicapped because a lot of the control frauds are connected to the elites of society.<sup>626</sup>

It is important to reiterate the position of Sanusi:

‘...We were dealing with chief executives that in 2009 had become invincible. They were in the seat of power. They had economic power and they had bought political protection. They were into political parties, they had financed elections of officers and they believed that nobody could touch them. And every time I said it was time for us to take action, people said to me you can't touch these people, you'll be sacked. Or you can't touch

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<sup>624</sup> ‘Getting Banks to Lend Again’ BGL Banking Report, 2010, 15-16  
<[http://www.bglgroupng.com/docs/banking\\_report.pdf](http://www.bglgroupng.com/docs/banking_report.pdf)> accessed 12 January 2014.

<sup>625</sup> Florence, D. ‘The Politics of Central Banking and Implications for Regulatory Reform in Sub-Saharan Africa: The Cases of Kenya, Nigeria and Uganda.’ Discussion Paper, 2012, 11 <[http://www.die-gdi.de/uploads/media/DP\\_2.2012.pdf](http://www.die-gdi.de/uploads/media/DP_2.2012.pdf)> accessed 19 December 2013.

<sup>626</sup> Chapter eight on Shareholders will identify the calibre of people that took loans in the banks, majority of whom were politicians.

these people they will kill you. Or you can't touch these people, you can't do that....'<sup>627</sup>

That notwithstanding, the position of the CBN Governor is also one of a (political) appointment by the President; whereby nomination is passed to the National Assembly for confirmation. It is no news that owing to Nigeria's multi-ethnicity, and in a so-called bid to ensure fair representation, political appointments are made on a Zonal basis,<sup>628</sup> a prejudicial arrangement which is not in the best interest of the country, particularly where eligible candidates are overlooked based on political imperatives.

Furthermore, there is the lack of independence in the proper functioning and administration of the CBN. Banking licences were given due to political connections. This also led to non-compliance to regulation in many instances because many of the top executives in the Nigerian financial sector have major ties and connections to political groups. Due to this, they depend on them for their livelihood and were quick to compromise based on this relationship.

Prior to his appointment, the former CBN governor, Professor Charles Soludo, from Eastern Nigeria, was the Chief Economic Adviser to the then President of Nigeria, General Olusegun Obasanjo<sup>629</sup>, a Southerner. Professor Charles Soludo, an accomplished economist of international repute<sup>630</sup> failed

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<sup>627</sup> See Chapter four on CEOs; Sanusi Lamido explodes: How vested interests are killing Nigeria. <http://www.premiumtimesng.com/news/153212-sanusi-lamido-explodes-how-vested-interests-are-killing-nigeria.html> accessed 22 December 2014

<sup>628</sup> It is important to state that Nigeria comprises six geo-political zones, namely South-South, South-East, South-West, North-West, North-Central and North-East with a total 36 States (Including the Federal Capital Territory Abuja) The CBN Governor is from North-West (Kano State) and none of the five CEOs were from North-West.

<sup>629</sup> Soludo was CBN Governor from 2004 to 2009. He was however Chief Economic Adviser to the president from 2001 to 2009. See Central Bank of Nigeria. (Former Governors Profile

<http://www.cenbank.org/AboutCBN/RetiredExecutive.asp?Name=Prof%2E+Chukwuma+C%2E+Soludo%2C+CFR> accessed 21.01.15

<sup>630</sup> Ibid

to take adequate measures that could have prevented the financial meltdown in the country at the time.

Perhaps the reason for lack of a more drastic approach is not farfetched and can be likened to political/regulatory forbearance leaving no apparent option than the continuous funding of these banks with the Expanded Discount Window.

It must be stated that Mallam Sanusi L. Sanusi who succeeded Soludo was appointed no sooner than the late President Umaru Yar'Adua, assumed power. It must be mentioned here that both of them were Northerners. The general belief in Nigeria is that Mallam Sanusi was on a mission to take over the banks from southerners and easterners because the northern elites did not have considerable representation in the banking sector. Therefore, as soon as Sanusi was at the helm of affairs in the CBN, he set out to remove the five Managing Directors of banks, all of which so happened to be Southerners and Easterners, with no Northerner amongst them! There is therefore a struggle between tribal elites in Nigeria; this is a prejudicial belief that has eaten deep into every sphere of the economy and may be difficult to eradicate.

One credit that ought to be given to Sanusi, however, was the bold and unusual step taken to publish the names of the debtors of these banks and to reveal the relationship between top politicians and bank executives.<sup>631</sup>

Mention must also be made that concerns were raised prior to the outbreak of the financial crisis by a minority of CBN workers and also the NDIC.

Notably, Sanusi stated:

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<sup>631</sup> See the CBN list of Bank debtors available at <http://www.vanguardngr.com/2009/10/cbn-releases-fresh-list-of-bank-debtors/#sthash.NMrZTvFW.dpuf> accessed 17.10.14. this will be explained more in chapter eight.



‘The sad story in all of this is we now have evidence that junior officers in the CBN did document their concerns to CBN top management at that time, but no action was taken. We also have evidence that the NDIC documented its concerns but its efforts to get the CBN leadership to act quickly were rebuffed.’<sup>632</sup>

Perhaps a listening ear to the concerns raised might have gone a long way. However, in a situation where the government is in strong ties with the CBN, efforts to report ‘*Peter to Paul*’ cannot do much in the end.

### **6.7.3 Judicial Factors**

It is important to also note the problem associated with the Judiciary and how Nigeria’s political environment has been used to influence the CBN’s intervention during the crisis. Although legal action was jointly taken by the CBN and the EFCC, to date, only one of the five cases has been decided in Nigeria, what is seen is the rest of the executives fleeing the country either on medical grounds or as the case may be.

The table below is an extract from the EFCC showing the status of the top five cases of fraud involving the CEOs of the banks in question.

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<sup>632</sup> Sanusi Lamido Sanusi ‘The Nigerian Banking Industry: What went wrong and the way forward (Convocation Lecture, Bayero University, Kano, 26 February, 2010) 5. [http://www.cenbank.org/OUT/SPEECHES/2010/THE%20NIGERIAN%20BANKING%20INDUSTRY%20WHAT%20WENT%20WRONG%20AND%20THE%20WAY%20FOR%20WARD\\_FINAL\\_260210.PDF](http://www.cenbank.org/OUT/SPEECHES/2010/THE%20NIGERIAN%20BANKING%20INDUSTRY%20WHAT%20WENT%20WRONG%20AND%20THE%20WAY%20FOR%20WARD_FINAL_260210.PDF) accessed 22 October 2012

**Table 4**

<b>S/N</b>	<b>Banks / CEOS</b>	<b>Size of Non-performing Loan (N)</b>	<b>Status of Case</b>
<b>1.</b>	<b>Oceanic Bank Plc Mrs Cecilia Ibru</b>	<b>278.2 billion</b>	<b>Sentenced for 6 months and also forfeited assets worth N191.0bn</b>
<b>2.</b>	<b>Intercontinental Bank Plc Dr E. Akingbola</b>	<b>210.9 billion</b>	<b>On Bail, Assets frozen</b>
<b>3.</b>	<b>AfriBank Plc Mr Sebastian Adigwe</b>	<b>141.9 billion</b>	<b>On Bail, Assets Frozen</b>
<b>4.</b>	<b>Union Bank Plc Dr. E Ebong</b>	<b>73.6 billion</b>	<b>On Bail</b>
<b>5.</b>	<b>FinBank Plc Mr Okey Nwosu</b>	<b>42.5 billion</b>	<b>On Bail</b>
<b>Total</b>		<b>747.0 billion</b>	

Source: EFCC website

As seen above, the only trial that has been concluded is that of Mrs Cecilia Ibru, other cases have been going in and out of court due to the delay tactics inherent in the Nigerian legal system. Thus, this constitutes another problem that regulators face in carrying out their duties. It is no news that the judicial process in Nigeria is very slow and constant adjournments through delay measures can sometimes make plea bargaining a very attractive option.

The problem of the judiciary is further compounded by the duality of proceedings brought to court at the time. The notable case involving Afribank shareholders which discussed in the chapter six on shareholders

saw the judiciary turn a deaf ear to all the cries of the shareholders and ultimately carry out a grave miscarriage of justice when it was quick to strike out preliminary objections brought by the shareholders notifying the court of the duality of proceedings by the CBN.<sup>633</sup> Issues regarding judicial independence cannot be ruled out in Nigeria as power and manipulation become more evident on a daily basis.

## 6.8 Conclusion

Sanusi opined that the Nigeria banking sector has experienced several failures prior to the bank crisis; however, he described the banking sector incident of 2009 as a ‘monumental fraud’ because owners and managers of these financial institutions constantly devised means by which the banks were defrauded. The antecedent of the crisis purported financial institutions engaging in foreign exchange trading, direct importation of goods using hoax companies and purchasing government treasury bills, and banking licenses were easily obtained in order to trade in these non-core banking activities.<sup>634</sup>

There was laxity on the part of the CBN to scrutinize the quality of banks’ accounts in order to ensure accurate reports. Thus, the CBN’s internal reporting system was unable to serve as an effective warning system for banks’ misconduct.<sup>635</sup> Also, the integrity of CBN supervisory officials calls for concern. The banking examination department became the most sought department and officials compromised in issuing clean bills of health in their bank examination report. Incompetency is also another problem faced

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<sup>633</sup> Chapter eight sheds more light on this.

<sup>634</sup> Charles C. Soludo, ‘Consolidating the Nigerian Banking Industry to Meet the Development Challenges of the 21<sup>st</sup> Century.’ An address at the Special Meeting of the bankers’ Committee, Abuja, 6 July, 2004, 4

<<http://www.bis.org/review/r040727g.pdf?frames=0>> accessed 17 January 2014.

<sup>635</sup> Ibid 8

by bank officials and it is believed that most of the examiners lacked requisite skills in the phase of changing technology.<sup>636</sup>

From the foregoing, it must be said that the CBN statutorily has the power to regulate, monitor and supervise the activities of banks. Thus, the CBN has the power to contain the bank crisis of 2009. This includes the examination of the books of the banks, the removal and replacement of the banks MDs/CEOs, charging the affected MDs/CEOs to court, among others. It is important to state that prior to the banking crisis, the quality of corporate governance in the banking sector was very poor. Insider trading, fraudulent practices using the banks subsidiaries abound in the banking sector which triggered the bank collapse. The stupendous riches and assets of some of the indicted MDs/CEOs and other directors show that the rot in the banking system was overwhelming. In fact, some of the banks were used as conduits for money-laundering, which aggravated the deplorable condition in the banking sector.

In conclusion, it can be said that the CBN failed in performing its duties, over-stepped its bounds, particularly in its refusal to provide the necessary documents and reports used throughout the banking crisis. This depicts an institution that purports to have more powers than the people's representatives (Legislature).

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<sup>636</sup> Ibid 12

## Chapter 7

### An Assessment of the Role of Auditors in the Banking Crisis

#### 7.1 Introduction

In financial markets, external auditing is seen as a necessary measure of trust in order to create a formalised and legible relationship subject to independent validation.<sup>637</sup> The past decade witnessed financial crisis across the globe and revealed control frauds by Chief Executive Officers (CEOs) and the inability of auditors to prevent or expose these practices have become a major concern. In Nigeria, despite the fact that credible financial performance remains vital to the growth of the economy, the independence of auditors is a rather complex issue and doubts are raised as to whether auditors are indeed part of control fraud.

The 2009 banking crisis has since raised unanswered questions as to how regulators and even external auditors could have prevented the crisis. This sense of doubt about the independence and credibility of the external auditors leads to conclusions as to whether it was a case of gross negligence or silence in conspiracy to the fraud. In this regard, it is the focus of this chapter to critically examine the involvement of auditors in Nigeria in the banking crisis using the big five banks as case studies. The chapter will first examine the ambiguity of auditing created by an 'expectations gap'. This will then be followed by analysis of the law relating to auditors in Nigeria as well as guidelines with regards to Nigerian audit standards to analyse the purpose and function of auditors and the nature of audit reports. Examination of the evidence of audit failure in Nigeria would then follow. This is to determine the role played by auditors in the banking crisis, using

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<sup>637</sup> Power, M. (1999) 'The Audit Society: Rituals of Verification' Oxford: Oxford University Press

the five banks as case studies. The last part would investigate the reasons for audit failure in order to assess whether the auditors were indeed part of the control fraud and also whether their independence could have been compromised due to the nature of totality of services provided known as non-audit services.

The chapter critically examines legal, regulatory and practical problems of auditing in Nigeria and why the audit reports had failed to reveal true financial situations of the banks as it would be later revealed that each of the top five banks succeeded in getting at least one clean opinion from a top-tier audit firm. The purpose of this chapter is to stimulate reflection on the limitations of financial auditing within the dynamics of independence and professionalism. It can be said apart from institutional corruption which has eaten deep across various spheres of the Nigerian economy, commercialisation of audits through non-audit services also accounts for non-independence of auditors and lack of audit quality; therefore, audit firms are no different from the many corporations that tend to engage in fraudulent and anti-social practices in the name of profit maximization, shareholder value and financial performance.

An important problem, however, lies in the lack of documentary evidence regarding non-audit fees and in as much as it is clear from auditor-client relationships in Nigeria that non-audit services are being provided, the lack of documentary evidence for this remains an overwhelming concern.

## **7.2 The Obscurity of Audit: An Expectations Gap**

Although it is logical to commence any discussion of the role of auditors with a definition of audit, it is however also important to clarify the contradiction regarding the actual and expected performance of auditors and indeed auditing, also known as the obscurity of audit.

In his book: *'The Audit Society: Rituals of Verification'*,<sup>638</sup> Michael Power offers a systematic exploration of 'audit' as a principle of social organisation and control. He provides a critical investigation of the means, reasons and consequences of what he calls the 'audit explosion', and by raising critical questions on the effectiveness of audit processes, he posits that the consequences arising from these processes must be weighed and contrasted against theories and practices of trust.<sup>639</sup>

He analyses the obscurity of audit and explains that the expectations and reality of audit are two different things. While audit may be aimed at detecting financial problems in an organisation, it is impossible for an audit to know for certain that there is no fraud. Power compares the difference between Audit explosion and Audit society. According to him, audit explosion refers to the set of attitudes and cultural commitments that are targeted at problem solving; audit society on the other hand, is made up of the totality of tendencies that are revealed by these commitments, which are different from an objectively identifiable state of affairs, and are drawn from longstanding practices of financial auditing.<sup>640</sup> In other words, audit explosion is the way and manner audit is conducted while audit society is made up of the totality of possibilities revealed by audits. Power further considers the problematic relationship between auditing as a financial practice and the goal of fraud detection. According to him, there is an 'expectations gap' whereby the trend of Regulations and Guidance on functions of auditors creates a responsibility of detection of fraud, compounding the process of producing a credible role for auditors in the midst of high and low expectations and where this aim of financial audit is not attained, as in detection of fraud, it is believed that audit has failed.<sup>641</sup>

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<sup>638</sup> Power, Ibid

<sup>639</sup> Ibid 4-9

<sup>640</sup> Ibid

<sup>641</sup> Ibid 25-26

Power believes that this problem creates a dilemma on the potential and operational capability of auditing. As further explained by Power:

‘The knowledge base of financial audit process is fundamentally obscure. It is this obscurity which sustains the expectations gap. An obscurity which practitioners overcome by appealing in the end to the authority of their own judgment in determining what is reasonable practice. However, it must also be emphasized that to draw attention to this obscurity is not to regard auditing as a fiction or myth.’<sup>642</sup>

In this regard, it can be said that the ambiguous nature of auditing is not a methodological problem but a substantive fact as to the expectations and reality of audit. Auditing as a concept is an embodiment of ideas of social norms and hopes. Auditors have really obfuscated the issue of what auditors really do and this obscurity of auditing coupled with the problem analysed above regarding difficulty in separating the success of auditing from the success of the company is indeed very crucial to the ‘Expectations Gap’.

Furthermore, a ‘Clean’ opinion by an audit firm would not necessarily draw a conclusion of a true and fair financial state of affairs.<sup>643</sup> This is because as mentioned above, auditors cannot state for certain that there is no fraud, but rather, they can only state that their samples did not reveal one.

Grabosky identifies audit failure is a form of ‘Gatekeeper failure’ which stimulates chains of reaction ranging from litigation to inquiries at various levels.<sup>644</sup> Furthermore, while corporate failure would generally give rise to the public questions regarding audit failure, corporate success does not

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<sup>642</sup> Ibid 30

<sup>643</sup> Ibid 25-26

<sup>644</sup> Grabosky, P. N. (1995b), ‘Using Non-Governmental Resources to Foster Regulatory Compliance, *Governance*’ 8(4) *An International Journal of Policy and Administration* 527. 539



usually yield public praise for the role of audit. In view of this, the success of auditing must be disentangled from the success of the company audited, however difficult it may seem.<sup>645</sup>

The issue of what audit can and cannot do is therefore one of concern. It is pertinent to note that the functions of auditors are in fact limited to the evidence before them which, depending on the management of the company could be biased without their knowledge, and it is quite possible that a 'good audit' could have been given to a 'bad company' if it was conducted prior to the collapse of the company and defences relating to audits usually comes in this form.

As considered by Keasey and Wright, although not all defences in relation to audits are successful, the idea of audit failure or success remains an elusive concept and audit failures may be impossible to judge because the activities of accounting and auditing are so vaguely defined.<sup>646</sup>

Power also seconds this when he posits that one issue that remains dazzling is that auditing lacks clear output based criteria of performance.<sup>647</sup> He goes further to say that there is a demand as to what audits actually produce and how to tell whether or not audits are indeed successful, however useful it might have been in defining practical goals, corporate compliance and organisational performance. This issue is fundamental to any type of audit. Likewise, definitions of auditing do not usually reflect economic constraints (such as limited sampling) of auditing as a whole and regardless of whether audit processes are very expensive, the truth remains that auditing and

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<sup>645</sup> Power (n. 637) 27

<sup>646</sup> Keasey, K and Wright, M. (1993): 'Issues in Corporate Accountability and Governance' An Editorial, 23 *Accounting and Business Research* 291.299

<sup>647</sup> Power (n.637) 25-27

indeed any other form of monitoring lack the almost infinite resources necessary for the performance of the task.<sup>648</sup>

Auditing as a process is quite rigorous in itself, involving Time and Cost Input in order to produce assurance, thereby promoting credibility of the audited object (in this case, financial statement) and ultimately adding 'economic value' to it. The output of audit, therefore, is the production of a report that the financial statements offer a 'true' and 'fair' view of the company.

According to Power, the obscurity, however, lies in the series of questions that would then arise:

- What is the nature of assurance given by audits?
- Can it be observed?
- Can it be measured other than in broad qualitative terms or in terms of a consensus among auditors themselves?
- It may not really be possible to know what audits really produce but can one at least ascertain whether auditors come to similar conclusions in similar circumstances?
- Is it simply the case that more staff will yield more assurance?<sup>649</sup>

Going from this point of view, the assertion of Power that auditing has a weak knowledge base can be said to be true and although auditing generally tends to assert the value which it adds, however true it may seem, the fact remains that there is 'no way of specifying the assurance production function' independently of the auditors own qualitative opinion process leading to the conclusion that there may something fundamentally unspecifiable regarding its output.<sup>650</sup>

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<sup>648</sup> Ibid

<sup>649</sup> Ibid 28

<sup>650</sup> Ibid 28-29

From the above, it can be said that the problem of auditing lies in the level of expectations gap that is put into it, particularly in the prevention of fraud. As identified by Power, the inability of audit in detecting fraud should not be construed to mean it has failed. It therefore suffices to conclude that the result of auditing is limited by the evidence placed before it, even in the absence of control fraud because auditors cannot check everything.

However, in Nigeria, it is pertinent to note that going by virtue of Section 360(1) of CAMA, auditors are allowed to carry out necessary investigations in order to make their report, particularly to verify whether the company's accounting records matches its balance sheet. Also, in Section 360(3), auditors have a right to access the company's books and accounts, and can request for any other documents needed for the performance of their duties. Also, Section 359(2) of the Act (as would be further explained in this chapter) provides that the auditor's duty is 'to provide an opinion whether, to the best of their information and according to the explanations given to them by the company, the said statements give a true and fair view of the financial status of the company'.<sup>651</sup> However, depending on the motive of the management of the company, a control fraudster will go to extra lengths to conceal vital financial information from the auditors.<sup>652</sup> Auditors may not be in a position to identify ongoing control fraud in the company. As previous chapters on control fraud explain, fraud is theft by deception and control fraudsters are financial super-predators,<sup>653</sup> it is therefore possible that the real state of affairs of the company might have been deliberately concealed from the external auditor.

It is quite plausible that vital information could be compromised without the auditor's knowledge, therefore making it possible that a 'good audit' could have been given to a 'bad company' if it was conducted prior to the collapse

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<sup>651</sup> CAMA, 2004, s. 359(2)

<sup>652</sup> The problem of control fraud as it relates to auditors is further discussed later in the chapter

<sup>653</sup> See Chapter two on Definition of Control Fraud.

of the company and defences relating to audits usually come in this form. Notably, one member of a reputable accounting firm in Lagos was observed to have said the following in the defence of auditors:

‘It is not the job of the accountants to go deep into the papers. The law places the onus of preparing the account on the directors of the company. What the auditors are doing is to ascertain that the account is well prepared and that all the necessary checks and balances are there and that all the regulations that should have been followed are followed. If they see anything that is not proper in the account, it is their duty to point it out. You cannot really blame the accountant because some management hide things from the auditors.’<sup>654</sup>

Due to the above, it is right to say that auditors may indeed be vulnerable to the wave of control frauds in the company and this possible but fundamental constraint to external auditing remains a live concern.

However, in the case of Nigeria, it remains to be seen whether or not the auditors were indeed ignorant of the ongoing wave of frauds in the banks. As will be later revealed in this chapter, the problem arises in the oligopolistic structure of market for audit and non-audit services. The impairment of auditor independence in an institutionalised society where corruption is endemic will only lead to the suggestion that auditors might have indeed been a part of the fraud.

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<sup>654</sup> Otusanya, J., and Lauwo, S. (2010). ‘The Role of Auditors in Nigerian Banking Crisis.’ *Accountancy Business and the Public Interest*, 9, 159.193 (Quoting Femi Dinah’s statement (a partner of an accounting firm in Lagos) in Daily Independence, 28 September 2009)

### 7.3 The concept of Auditing

Following from the above, it can be said that any attempt to define auditing is basically an attempt to define what auditing *could* be.

According to Kiger and Scheiner, Audit or Auditing is:

‘the systematic process whereby a competent, independent person objectively obtains and evaluates evidence regarding assertions about an entity or event, for the purpose of forming an opinion about and reporting the degree to which the assertions conforms to an identified set of standards.’<sup>655</sup>

Tandon, Sudharasanam and Sundharabahu also consider audit as a thorough and intuitive examination of facts in order to provide an expert opinion in the form of a report, certificate or attestation.<sup>656</sup> There is therefore a notion of professionalism on the part of the auditor which would indicate that the auditor must be a certified accountant. Beatline also examine the concept of audit to be an examination of a series of financial statements, including book-keeping, accounts and records by an independent expert (individual or firm), known as the auditor, leading to the provision of an opinion or report.<sup>657</sup>

Another definition views audit as ‘a process of obtaining and evaluating evidence concerning assertions and economic actions as well as events in order to objectively ascertain the level of correspondence the assertions and

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<sup>655</sup> Kiger, J.E. and Scheiner J.H. (1994). *Auditing 1<sup>st</sup> Ed.*, Houston: Houston Mifflin Company, USA

<sup>656</sup> Tandon, B.N.; Suddharsanam, S; and Sundharabahu, S. (2006). *A handbook of Practical Auditing*, (13<sup>th</sup> Ed) New Delhi: New Delhi; S. Chand &Company Ltd p. 24

<sup>657</sup> Beatline, A. (1992). ‘What is and Audit?’ XXV(1)*The Nigerian Accountant*, 41

the established procedures which are then tendered in the form of a report to interested parties.’<sup>658</sup>

Power considers auditing to be ‘an independent examination of, and expression of opinion on, the financial statements of an enterprise.’<sup>659</sup>

He further identified four conceptual ingredients as the root of any audit practice:

1. Independence from the matter being audited
2. Technicalities of form of evidence gathering and the form of examination of documentation
3. The expression of a view based on this evidence, usually contained in a formal audit report
4. A clearly defined object of the audit process which, in most cases, are usually the financial statements.<sup>660</sup>

Audit can also be seen as a risk-reduction exercise which becomes necessary when principals (such as shareholders) are being exposed to ‘moral hazards’ by their agents (these include directors, managers or CEOs) and it is used to provide a true and fair situation of the company and to reduce the possibility of agents acting against the interest of their principals.<sup>661</sup> Flint examines situations that would require the necessity of audits. First is the issue of accountability whereby one party (usually the agent) is required to give account of his actions to another party (usually the principal). Second has to do with the complexity of the accountability relationship whereby the principals are distant from the actions of the agents

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<sup>658</sup> See Messier Jr. N. F. (2003). ‘Auditing and Assurance Services: A systematic Approach’ (3<sup>rd</sup> Ed), New York: McGraw-Hill Company Inc.

<sup>659</sup> Power (n. 637) 5

<sup>660</sup> Ibid

<sup>661</sup> It is interesting to also state that Economic models have been developed to demonstrate certain situations where agents will willingly demand to be audited and can voluntarily contract to be inspected. See Jensen, M.C. and Meckling, W. H. (1976), ‘Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure’ *2Journal of Financial Economics* 305-60

and as such, a lacuna is left, making them unable to personally verify the actions of the agents.<sup>662</sup>

Perhaps the most widely accepted definition of audits is that provided by the International Auditing Guidelines, which was issued by the International Federation of Accountants Committee (IFAC). The Guidelines defined Audit as: ‘an independent examination of, and the expression of an opinion on the financial statement of an enterprise, by an appointed auditor, in accordance with the terms of engagement and the observance of statutory regulations and professional requirements’.<sup>663</sup>

Audit constitutes a vital part of accounting. The contemporary nature of audits requires verifying financial statements and records of a company or entity. However, as observed by Danjuma et al.,<sup>664</sup> generally, in the financial world, the objective of audits is for the professional auditor to provide an expert opinion on the financial statements of the company he has been provided with. This expert opinion would mean giving reasonable assurance that the provided financial statement indeed reflects a ‘true and fair’ view of the financial situation of the company and has not simply been inflated, having been provided according to the applicable financial framework.<sup>665</sup>

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<sup>662</sup> Flint, D. (1988). *Philosophy and Principles of Auditing: An introduction*. London: Macmillan Education.

<sup>663</sup> See the definition provided by the IFAC at <http://www.ifac.org/auditing-assurance/auditor-reporting-iaasbs-1-priority> accessed 3rd August 2013

<sup>664</sup> Peter, Z., Jerry, M., & Danjuma, I. (2012). Assessment of the Adequacy of External Auditing in Disclosing Fraud in Nigerian Commercial Banks. 3(6) *Research Journal of Finance and Accounting*, 149-156.

<http://www.iiste.org/Journals/index.php/RJFA/article/view/2410> assessed 3<sup>rd</sup> August, 2013

<sup>665</sup> The applicable financial framework includes all requirements of accounting standards, laws and regulations applicable to the entity which determines the form and content of its financial statements. International Standards on Auditing (UK and Ireland) Objectives and General Principles Governing the Audit of Financial Statements Page 2 <http://www.frc.org.uk/Our-Work/Publications/APB/200-Objective-and-general-principles-governing-an.aspx> accessed 4th of August, 2013

Going by the above, an auditor can be said to be a person entrusted with the duty of scrutinizing books of accounts prepared by companies and vetting such books in order to pass a report to the shareholders which, in the opinion of the auditor would clearly indicate whether the prepared statement of accounts reflect a 'true' and 'fair' financial situation of the company.

In Nigeria, the law relating to auditing is majorly contained in the Companies and Allied Matters Act (CAMA) as well as the Institute of Chartered Accountants of Nigeria (ICAN) Act.<sup>666</sup> Auditing therefore becomes an important part of the administration of Nigerian companies due to the separation in ownership and control.<sup>667</sup> The shareholders as owners of shares with various rights in relation to the company share a common goal of profit-making, although they are normally not part of the day-to-day management of the company, they have in place appointed management whom shareholders expect to use the company's funds for profit maximization. The management can be said to be in 'control' of the company. Normally at the end of every financial year, managers are expected to prepare a quantitative analysis of how the company's funds have been managed during that year, this would then be verified by the auditors following acceptable standards that would assure the shareholders as well as third parties or external users<sup>668</sup> of the fairness of the financial statements or other subjects as the case may be.

#### **7.4 The Legal Roles and Obligations of Auditors**

Auditing plays an important role in Nigeria's financial sector, particularly the banking world whereby auditors' opinion in the form of reports is constantly relied upon for investment decisions.

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<sup>666</sup> CAMA, 2004, S. 357-369 which will be subsequently discussed in detail

<sup>667</sup> This is discussed in more detail in chapter six

<sup>668</sup> For instance, in the banking sector, these will include other stakeholders such as investors, depositors, etc



It becomes imperative to consider the role and obligations of auditors under Nigerian Law. This is to reiterate the fact that adequate audit standards exist in Nigeria, yet this was unable to prevent the banking crisis.

#### **7.4.1 Companies and Allied Matters Act 2004**

To start with, the need for the preparation and examination of financial statements is provided for in Section 331 (1) of CAMA which requires that every company must maintain and keep accounting records which must be verified. In Nigeria, the desirability of auditing streams from a series of legal and policy documents mentioned above. Section 357-369 of CAMA provides for the requirement of companies to have their accounts audited so as to verify their financial statements in order to verify that they indeed reflect the ‘true’ and ‘fair’ view of the company.

Section 357 (1) provides for the appointment of an auditor or auditors at each annual general meeting who will audit the company’s accounts and records for that financial year<sup>669</sup> and where for any reason, no auditors are appointed or reappointed at an annual general meeting, the directors may appoint a person in the interim.<sup>670</sup> The duration of the auditor(s) is normally for one financial year but can be reappointed at the next annual general meeting.<sup>671</sup> Furthermore, company auditors are entitled to attend general meetings of the company as any member of the company and also to receive notices regarding meetings and are also entitled to be heard at meetings on matters which concern them as auditors.<sup>672</sup> Remuneration and resignation is

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<sup>669</sup> However, CAMA, 2004, s. 357 (5) provides that the first auditors of a company may be appointed by the directors at any time before the company is entitled to commence business and auditor as so appointed shall hold office until the conclusion of the next annual general meeting:

<sup>670</sup> Ibid s.357 (3)

<sup>671</sup> Ibid s.357 (2) which provides that ‘at any annual general meeting a retiring auditor, however appointed, shall be re-appointed without any resolution being passed unless he is not qualified for re-appointment; or a resolution has been passed at that meeting appointing some other person instead of him or providing expressly that he shall not be re-appointed; or he has given the company notice in writing of his unwillingness to be re-appointed.’

<sup>672</sup> Ibid s. 363 (1)

provided for in Sections 361 and 365 respectively and remuneration of the auditor is determined by the company at the general meeting.

Auditors' duties, powers and responsibilities are provided for in Section 360 and as mentioned earlier, these include carrying out investigations that is necessary in assisting them to make will enable them to make their report on the accounting records of the company and whether the company's balance sheets are in accordance with its records. Subsection 5 of the Section allows for the auditor to state in their report any suspicions or doubts as to whether or not the information in the directors report for which the accounts are prepared is in agreement with those accounts.

As mentioned earlier, Section 359(2) sets out the information that should be contained in the auditor's report and these include the following:

- Whether they have gathered all relevant information relevant for their audit;
- Whether the company has kept proper books of accounts;
- Whether the company's profit and loss account and balance sheet are in agreement with its accounting records;
- Whether, in their opinion, and to the best of their information and according to the explanations given to them, the said statements give a 'true' and 'fair' view of the financial status of the company.<sup>673</sup>

#### **7.4.2 Statement of Auditing Standards (SAS) 100**

The Statement of Auditing Standards issued by ICAN provides general principles to govern audit of financial statements as well as summary of the role of auditors which states the following as requirements which should be considered by auditors in making their report. The auditor should:

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<sup>673</sup> Ibid s.359(2)

- Conduct investigations so as to gather necessary and relevant evidence according to the audit standards and also to determine whether the financial statements are free of mis-statements.
- Evaluate whether the overall financial statements have been prepared following relevant legislation and accounting standards, and;
- Issue a report, which contains an expression of the auditor's opinion on the financial statements.<sup>674</sup>

### **7.4.3 National Standards on Auditing (NSA)**

Similarly, ICAN also issued the NSA which provides that the objective of the auditor is to gather sufficient necessary evidence in investigating whether:

- Accounting estimates, including fair value accounting estimates, in the financial statements, whether recognized or disclosed, are reasonable; and
- Related disclosures in the financial statements are adequate, in the context of the applicable financial reporting framework.<sup>675</sup>

It is pertinent to note another important provision of the NSA 23 to the extent that it is the responsibility of the auditor to assess the entity's ability

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<sup>674</sup> Institute of Chartered Accountants of Nigeria; Nigerian Standards of Accounting Statement of Auditing Standard (SAS) 100: Para.2 'Objective and General Principles Governing an Audit of Financial Statements' <http://www.frc.org.uk/Our-Work/Publications/APB/SAS-100-Objective-and-General-Principles-Governing.aspx> accessed on 4th August, 2013. The SAS 100 contains basic principles and essential procedures to be followed by auditors in the conduct of audits in Nigeria. These principles are quite similar to the Nigerian auditing practices standards contained in the Financial Reporting Council Act of 2011.

<sup>675</sup> Accounting Estimates is defined as 'an approximation of a monetary amount in the absence of a precise means of measurement and refers to an amount measured at fair value where there is uncertainty as to estimation of amount.' See Paragraphs 7-8 of the Institute of Chartered Accountants of Nigeria Nigerian Standards on Auditing (NSA) 20 on Auditing of Accounting Estimates Including Fair Value Accounting Estimates and Related Disclosures. [http://www.icanig.org/.../NIGERIAN\\_STANDARD\\_ON\\_AUDITING.doc](http://www.icanig.org/.../NIGERIAN_STANDARD_ON_AUDITING.doc) Last accessed on 4th August, 2013

to carry on as a going concern.<sup>676</sup> The going concern assumption views the entity as being able to continue in business for the foreseeable future.<sup>677</sup> This responsibility exists regardless of whether or not the financial reporting framework with which the entity used in preparing its financial statement has expressly mentioned the need for the entity to assess whether the entity was able to continue as a going concern.

Paragraph 10 provides the objectives of the auditor in this regard and includes investigation of the appropriateness of managements use of the going concern assumption and to determine within the circumstances whether any material uncertainty or irregularity exists as to place a doubt on the company's ability to continue as a going concern and the implications for this. It should also be mentioned that although absence of any reference to whether the company is a going concern should not be construed to mean a guarantee as to the entity's ability to continue as a going concern due to the fact that auditors are unable to predict such future conditions or events. However, the provision of this clause should not undermine the overall going concern objective.<sup>678</sup>

### **7.5 The Audit Report: A Quality Label**

Crucial to the auditor is the preparation of the audit report. The audit report is a statement attesting to the validity or otherwise of the financial statements, profit and loss accounts and records presented before the auditor, including all group financial statements examined by them.<sup>679</sup> The report must be made in accordance with the auditing practices standards as

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<sup>676</sup> Ibid NSA (23) on Going Concern, para.5

<sup>677</sup> Ibid para. 4

<sup>678</sup> Ibid para.9-10

<sup>679</sup> CAMA, 2004, s. 369 (1)

provided for in Section 25-26 of the Financial Reporting Council (FRC) Act of Nigeria 2011.<sup>680</sup>

In the preparation of the audit report and indeed in discharging his roles, the fiduciary duties of care, diligence and skill is important to the auditor to the extent that his duties are carried out independently and his report reflects a true and fair view of the financial situation of the company.<sup>681</sup> In addition to this, in the case of public companies, the auditor shall also make an audit report to an audit committee which shall be established by the company. According to Section 368(3), the audit committee shall consist of an equal number of directors and representatives of the shareholders of the company and shall be subject to a maximum of six members who shall examine the auditors' report and shall make recommendations as it may deem fit to the annual general meeting (Section 368 (4)). This is however subject to the fact that no member of the audit committee is to be provided with remuneration and shall be subject to annual re-election.

It is important to note that CAMA makes no provision regarding the types of directors that should be consisted in the audit committee. However, the Code of Corporate Governance 2006 seems to make a clearer position on this when it provides in Section 8.1.4 that:

‘Members of the Board Audit Committee should be non-executive directors and ordinary shareholders appointed at AGM and some of them should be knowledgeable in

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<sup>680</sup> Formerly known as the Nigerian Accounting Standards Board (NASB). Section 25-26 of the FRC Act makes provision for the directorate of Accounting and Auditing practices standards and establishes basic principles to which external auditors in Nigeria are to comply with in the discharge of their duties.

<sup>681</sup> CAMA, 2004 s. 368 (1). The circumstances in which an auditor could be found liable vary. For instance, in the Australian case of *AGC Advances Ltd V. R. Lower Lippman Figdot and Frank* (1991) ASCSR 337, where a company auditor had failed to reconcile the figures in the accounts with the total stock sheet figure thereby failing to quantify the audit stock which subsequently led to an over valuation. The court decided that the appropriate standard of care was that adopted by the Australian Society of Accountants as well as the Institute of Chartered Accountants and held that the auditors were guilty of breach of duty of care in this regard.

internal control processes. One of such appointed ordinary shareholders should serve as the Chairman of the Committee’.

Section 368(2) of CAMA provides that the auditor shall be liable for negligence upon institution of an action for negligence by the directors where a company suffers damage owing to failure of the auditor to perform his fiduciary duties. The Section goes further to provide that where the directors fail to institute an action against the auditor, any member may do so, after giving 30 days notice of his intention to institute such action. Going by this provision, it can be said that an action by the shareholders of the company against the directors would subsequently mean an action against the auditors for negligence. Furthermore, it is an offence for any officer of the company to provide false, misleading or deceptive information to the auditor where this information is required by the auditor in the discharge of his duties, which includes preparation of the audit report.<sup>682</sup> It is the responsibility of the directors of the company to provide the financial statements after which the auditors’ duty is to provide a professional opinion as to the validity or otherwise of the statements and the audit of financial statement do not relieve the directors of these duties.<sup>683</sup>

As stated earlier, the provision of an auditor’s opinion in the form of an audit report should not be construed to mean a guarantee of the viability of the entity. In this regard, according to Principle 8 of SAS, the term ‘reasonable assurance’ is central to the provision of an audit in accordance with the applicable financial framework and it is the duty of the auditor to verify that the provided financial statement is free from any material misstatement. This opinion is provided based on facts and judgement and the opinion provided by the auditor based on financial statements is to provide a

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<sup>682</sup> CAMA, 2004 s. 369 (1). The Section goes further in sub-section (2) to impose a penalty of fine or imprisonment to any person guilty of this offence.

<sup>683</sup> SAS 100 (n.674) Para. 6

‘reasonable’ and not ‘absolute’ assurance and this would not include an assurance as to the efficiency with which the affairs of the entity are being managed or conducted.<sup>684</sup>

In his view, Power provides a useful context on the level of assurance produced by audit reports by comparing auditing to inspection. The audit report in itself is seen as an attempt to communicate the fact that minimum standards required for corporate financial statements have or have not been achieved and as discussed above, in the case of Nigeria, these standards are detailed in the NSA. While some forms of inspections issue certificates in the form of ‘license for practice’ which could mean ‘fit for purpose’, an audit report on the other hand is different from a license. Although it is a legal requirement for companies to have audit reports, companies are not automatically prevented from trading or being listed on the stock exchange merely because accounts are ‘qualified’, that is, if the auditor issues a negative report. It therefore follows that the qualified audit reports are not directly linked to regulatory machinery.

However, the pressure has always been on financial audit to say more in its report, and whether audit reports indeed fall nothing short of professional opinion; that is: ‘is audit report a quality label or does it help provide deeper understanding of the process undertaken?’<sup>685</sup>

Furthermore, the trend of describing what audit is not has led to loss of confidence in audit report. Stressing issues that are not covered by audit (such as product quality, safety and the like) has contributed to uncertainty as to what is actually contained in the audit opinion.<sup>686</sup> It is important to therefore distinguish the audit report from other forms of inspections such as product quality, safety and the like. Generally, these forms of inspections

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<sup>684</sup> SAS 100 (n.674)

<sup>685</sup> Power (n.637) 125; Oslon, S. K. And Wootton, C. W. (1991), ‘Substance and Semantics in the Auditor’s Standard Report’, 18(2)*The Accounting Historian’s Journal* 85-111

<sup>686</sup> Power (n.637) 125

lead to issuing of certificates produced in the form of licences with clear messages that the facility, organisation or individual has met the required standards of operation and is ‘fit’ for a defined purpose.<sup>687</sup> Issuance of the license would lead the public into believing that the organisation is operating according to legal standards, just as revocation of the license would suggest otherwise. These certificates are not designed to engage in communication but rather, they provide a ‘one-way signal which is ‘fit’ or ‘not fit’ for purpose. The irony is that in the financial world audit actually functions as a ‘quality label’ which will be unambiguous in an environment where there is a notion of what quality actually is and significant level of trust is placed in the professionalism of auditors producing the quality label as a ‘Fit for Purpose signal’.<sup>688</sup>

As Power suggests, at first glance, it may seem that audit works this way as audits generally say little about the company itself.<sup>689</sup> The audit report is seen as an attempt to communicate whether or not financial statements have complied with minimum standards of the applicable legal framework and very little is said about the company itself. The problem here, however, is that the audit report is not quite a license in itself as in the above explanation. While it is important for all public companies to have such a report, however, a negative report or a ‘qualified’ report would not prevent them from trading or being listed on the Stock Exchange. Furthermore, as noted by Ayres and Braithwaite, the qualified report is simply a professional opinion and is not directly connected to a regulatory machinery of escalation.<sup>690</sup>

It therefore follows again that the implications of ‘quality label’ or ‘fitness for purpose’ would be creation of expectations gap between those who read

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<sup>687</sup> Ibid. For example, cleanliness, apprenticeship, and so on.

<sup>688</sup> Ibid, 124-125

<sup>689</sup> Ibid, 124

<sup>690</sup> Ayres, I. And Braithwaite, J. (1992), *Responsive Regulation: Transcending the Deregulation Debate* New York: Oxford University Press



and those who produce them. The actual meaning of ‘true’ and ‘fair’ view in an auditor’s report becomes an issue. Power further delves into the fundamental issue posed by this difficulty, which is contrasting quality label style of auditing with the longer form of narrative reporting as seen in Value for Money audits<sup>691</sup>. He posits that quality label audits largely exist to communicate comfort rather than discomfort, that is, certification rather than non-certification is usually the case. In such a situation, if the auditor is dissatisfied, the only option is to exercise ‘exit’ rather than ‘voice’, that is, to refuse to provide an opinion, and this is usually a last resort. The pressure to produce comfort is based on the fact that too much critique may lead to sacking of the auditor.<sup>692</sup>

It can therefore be said that going from the above, while the adversarial nature of auditing may lead to conflict within the audited company or entity while also creating potential problems for regulatory bodies, the production of comfort, on the other hand, would mean lack of success of auditing in revealing problems; therefore auditing as a quality label and its implications of comforting or criticizing remains a subject of debate.<sup>693</sup>

## **7.6 The impact of Non-Audit Services (NAS) on auditor independence**

It is important to start by saying the word ‘non-audit services’ is not used in the CAMA. This is important to the effect that CAMA did not specifically prohibit NAS. Also, the two major bodies that regulate auditors in Nigeria<sup>694</sup> have failed to have a detailed regulation regarding the provision of NAS. In order to discuss this, it is first important to examine NAS.

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<sup>691</sup> Value for Money audit is an independent, evidence-based investigation that investigates whether economy, effectiveness and efficiency have been achieved through the use of public funds.  
[http://www.niauditoffice.gov.uk/index/aboutniao/value\\_for\\_money\\_audit.htm](http://www.niauditoffice.gov.uk/index/aboutniao/value_for_money_audit.htm) Value for Money Central Government accessed 02.09.13

<sup>692</sup> Power (n.637) 124.

<sup>693</sup> Ibid, 125

<sup>694</sup> These are the Institute of Chartered Accountants of Nigeria (ICAN) and the Association of National Accountants of Nigeria (ANAN)

Non-audit services include all services provided by an auditor that are not considered as an audit.<sup>695</sup> These may be Management Advisory Services (MAS) or Compliance related services (Tax, accounting or financial services). Over time, writers have argued for and against whether auditors should be allowed to provide NAS. Kimney et al. argue that provision of non-audit services could lead to better audit. In their opinion, when auditors are being saddled with the responsibility of auditing a company, it is important that they have a comprehensive knowledge of their client, and the totality of this knowledge coupled with their professional skills and knowledge would help gain more familiarity with the client, which will then help to improve quality and accuracy of the audit report.<sup>696</sup>

While a number of writers have noted that provision of non-audit services to a client should indeed enhance the auditors' knowledge of their client and should serve to promote objectivity and independence of the auditors,<sup>697</sup> others have further opined that the question of whether provision of non-audit services impairs audit independence remains yet unproven.<sup>698</sup>

On the other hand, Ye, Carson and Simnett examine the relationship between non-audit services, audit tenure, audit clients, alumni affiliation and their impact on audit independence and posit that auditors' dependence on

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<sup>695</sup> Adeyemi, S. B., Olowookere, J. K. 'Non-audit services and Auditor Independence – Investors perspective in Nigeria' 2(5) *Business and Management Review*, 89-90  
[http://www.businessjournalz.org/articlepdf/BMR\\_2509july2512h.pdf](http://www.businessjournalz.org/articlepdf/BMR_2509july2512h.pdf) accessed 2nd August, 2013

<sup>696</sup> Kinney, W.R., Palmrose, Z. & Scholz, S. (2004). 'Auditor independence, non-audit service and restatements: Was the US government right?' 42 *Journal of Accounting Research*, 561 – 588. See also See Jenkins, J.G. & Krawczyk, K. (2002). 'The Relationship between Non-Audit Services, and Perceived Auditor Independence.' Fall/Winter *Journal of Business and Economic Perspectives*, 25-36.

<http://www.acis.pamplin.vt.edu/faculty/jenkins/Vita.pdf> Last accessed 02.08.13; Lennox, C.S. (1999). 'Non-Audit Fees, Disclosure and Audit Quality.' 8(2) *European Accounting Review* 239-252

<sup>697</sup> Jenkins, J.G. & Krawczyk, K. (2002). Ibid

<sup>698</sup> Pringle, L.M. & Bushman, T.A. (1996). 'An Examination of Independence in Fact when Auditors Perform NonAudit Services for Audit Clients.' 6(1) *Accounting Enquiries*, 91-120; Hussey, R. (1999) 'The Familiarity Threat and Auditor Independence.' 7(2) *Corporate Governance*, 190-197.

non-audit services; prolonged audit tenure and personal relationships developed through alumni relationships would indicate biased auditor independence.<sup>699</sup> This is further corroborated by Hayes et al who suggested that the provision of non-audit services could impair auditor independence.<sup>700</sup>

Firth also examines provision of non-audit services and auditor independence. According to him, there is a risk that increased income arising from the provision of both audit and non- audit services can lead to the auditors' dependence on the client, and this could lead to lack of auditor independence but also the quality of the audit.<sup>701</sup>

Prohibition of non-audit services is generally premised on three factors:

1. An auditor cannot function in the role of management;
2. An auditor cannot audit his or her own work;
3. An auditor cannot serve in an advocacy role for his or her client.<sup>702</sup>

Furthermore, in the process of providing non-audit services, auditors tend to gain a close relationship with the management and this could lead to a situation of bias whereby auditors will take sides as opposed to abiding by laid-down regulations.

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<sup>699</sup> Ye, P., Carson, E., & Simnett, R. (2006). 'Threats to auditor independence: The impact of non-audit services, tenure and alumni affiliation.' *American Accounting Association*, 10-12

<sup>700</sup> Hayes, R., Dassen R., Schilder, A. and Wallage, P. (2005), *Principles of Auditors: An Introduction to International Standards on Auditing* Edinburgh: Pearson Education Limited. See generally Chapter 3; Shockley, R. (1981), 'Perceptions of Auditors' Independence: An Empirical Analysis' 56(4) *The Accounting Review*, 785-800

<sup>701</sup> Firth, M. (2002). 'Auditor provided consultancy services and their association with audit fees and audit opinions' 29(5)(6) *Journal of Business Finance and Accounting* 661 – 693

<sup>702</sup> Anichebe, A. S. (2010) 'Auditor Independence in the Global Environment' *Journal of Certified National Accountants of Nigeria, A Quarterly Journal of National Accountants of Nigeria*, July-September, 41-44.

<http://anan.org.ng/wp-content/uploads/2012/05/journaljanmar2011.pdf> Last accessed 25 September 2013

De Angelo considers auditor independence and suggests that auditors would trade their independence against the potential loss of reputation and costs that could arise from such compromise.<sup>703</sup> In view of this, it can be said that the biggest threat to auditor independence arises from the risk of losing a client. According to Beattie et al, the most frequent factors that undermine auditors' independence lies in the income generated from retention of a specific client particularly where more than 10 per cent of a firms' revenue comes from the provision of non-audit services.<sup>704</sup>

In contrast to its silence on NAS, it is necessary to state that CAMA disqualifies certain persons from serving as auditors.

Section 358 of CAMA reinforces the provisions of the Institute of Chartered Accountants of Nigeria (ICAN) Act, Cap I 11 LFN 2011, which disqualifies certain categories of people as auditors. The Section goes further to disqualify the following:

- An officer or servant of a company;
- A partner or employee of an officer or servant of a company;
- A body corporate
- Persons or firms employed by the company or connected with it in any form.<sup>705</sup>

Clearly the Section 358 prohibits 'firms' that have been in 'employment' or 'connected' to the company in any way from serving as auditors in the company. Nigerian writers have construed this to mean prohibition of non-audit services by an audit firm having connections or in employment with the company in any way either before or during the period of audit (Section

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<sup>703</sup> De Angelo L.E. (1981). 'Auditor independence, low balling, and disclosure regulation.' *3 Journal of Accounting and Economics* 113 – 127

<sup>704</sup> Beattie, V. A., Fearnley, S., & Brandt, R. T. (2001). *Behind closed doors: what company audit is really about*. Palgrave: Basingstoke

<sup>705</sup> CAMA, 2004 s.358

358(2)). It is believed that this is to prevent conflict of interest and promote auditor independence.

Adeyemi and Olowookere consider NAS and auditor independence in Nigeria. According to them, an interpretation of Section 358(2) would mean firms that provide professional advice in the form of consultancy such as secretarial services, tax or financial management are prohibited from being auditors of the company.<sup>706</sup> Provision of NAS could lead to conflict of interest and impair on the independence of the auditor.<sup>707</sup> The Local Authorities Pension Fund Forum (LAPFF), in 2010, considered that the prohibition of NAS is necessary primarily for the prevention of conflict of interest and also to promote independence of auditors.<sup>708</sup>

Furthermore, in the case of Nigerian banks, the BOFIA also reinforces the above provision in Section 29(3) where it prohibits the following people from serving as auditors of a company:

- (a) Having any interest in a bank otherwise than as a depositor; or
- (b) Who is a director, officer or agent of a bank; or
- (c) Which is a firm in which a director of a bank has any interest as partner or director; or

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<sup>706</sup> Adeyemi and Olowookere (n.695) 3

<sup>707</sup> Auditor independence is examined subsequently in the course of this chapter; Shockley, R. (1981), 'Perceptions of Auditors' Independence: An Empirical Analysis.' 56(4) *The Accounting Review*, 785-800; Knapp, M. (1985), 'Audit Conflict: An Empirical Study of the Perceived Ability of Auditors to Resist Management Pressure.' 60(2) *The Accounting Review*, 202-211.

<sup>708</sup> Local Authority Pension Fund Forum (LAPFF) on: 'Consultation on audit firms providing non- audit services to listed companies that they audit.' *APB Discussion Paper, Response by the Local Pension Fund Forum, January 2010*. P.3.

<https://www.frc.org.uk/Our-Work/Publications/APB/Consultation-on-audit-firms-providing-non-audit-se/Responses-to-Consultation-on-audit-firms-providing/Local-Authority-Pension-Fund-Forum.aspx> accessed 7 July 2014; Ebimobowei, A. (2011) 'Non Audit Services and the Impairment of Auditors' Independence: A further Examination' 8(2) *Pakistani Journal of Social Sciences* 100.105

(d) Who is indebted to a bank?<sup>709</sup>

Perhaps the most explicit prohibition of external auditors from providing non-audit services is contained in the Code of Corporate Governance for Nigerian Banks (Post-Consolidation) 2006. The code, to which compliance is mandatory for all banks, provides in Section 8.2.4 that a bank's external auditors should not provide the following services to their clients:

- Bookkeeping or other services related to the accounting records or financial statements of the audit client;
- Appraisal or valuation services, fairness opinion or contribution-in-kind reports;
- Actuarial services;
- Internal audit outsourcing services;
- Management or human resource functions including broker or dealer, investment banking services and legal or expert services unrelated to the audit contract.

Going from the provision of the Corporate Governance Code above, it can be rightly said that auditors are prohibited from providing non audit services in Nigeria.

In Nigeria, the oligopolistic nature of audit has led firms to be more drawn to mechanical compliance with professional auditing standards rather than audit quality and independence, and lot of effort is put in hiding loopholes and irregularities. Despite the fact that regulatory provisions exists to prohibit non-audit services as examined above, these provisions are hardly complied with or enforced in Nigeria.

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<sup>709</sup> Banks and Other Financial Institutions Act, 2004 s.29(3)(4)

As noted by Anichebe:

‘In Nigeria, Auditors accept all services (except those to which they have no competence of) as long as there are separate engagement letters. The existing independent rules are thus clearly breached. The same auditor is allowed to prepare and audit financial statements due to lack of qualified accountants.’<sup>710</sup>

It is important to also mention a disturbing issue at this point which is the lack of documentary evidence for actual non-audit fees, and as will be seen in the course of this chapter, the fees paid for audit also include non-audit fees but this is not expressly distinguished to state actual type of services provided and the amount paid for each. Perhaps the non-disclosure of NAS fees is a means to conceal this breach. Although it is clear from the relationships of audit firms and their clients that a lot of accounting and consulting services apart from auditing are being provided, documentation expressly stating this may be limited.

According to Ebimobowei, the two main important non-audit services provided by Nigerian auditors are Tax management and Consultancy services.<sup>711</sup> These fall under legal or expert services as prohibited under the 2006 Code enumerated above. Provision of these services clearly would jeopardize the independence of auditors, placing them in a conflicting position.

In a country like Nigeria, it is suggested that NAS should be clearly catered for in the regulation, this is to prevent a situation where corruption is sort of encouraged. It is important to also state that the fact that there are a few auditors in Nigeria should not mean that NAS should be allowed. It is

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<sup>710</sup> Anichebe (n.702)

<sup>711</sup> Ebimobowei, A. (n.708)

necessary to mention that while there are few auditing firms, accounting firms are however many; it is therefore suggested that NAS should be provided by accountants in order to protect the independence of auditors in Nigeria.

### **7.7 Evidence of Audit Failure: The Big Five V. The Big Two**

There are four big accounting firms in Nigeria and these are KPMG, Ernst and Young, Price PricewaterhouseCoopers (PwC) and Akintola Williams Deloitte (AWD), all of which are international audit firms. However, this chapter shall focus on the activities of two of these firms that were charged with the responsibility of auditing the big five companies and these include PricewaterhouseCoopers and Akintola Williams Deloitte. Although, mention must be made that two other firms were involved in the audits of the five banks. AWD worked with Baker Tilly Nigeria (BTN) in the audit of Union Bank and the same goes for Finbank. However, only AWD and PwC have been implicated in the banking scandals involving the five banks they were engaged to audit and have been accused of acts of professional misconduct and financial misstatements.

Various studies have been conducted to investigate the role of auditors in unethical practices in the Nigerian corporate sector.<sup>712</sup> According to Bakre, cases of Nigerian accountants and external auditors collaborating with management to falsify and knowingly overstate financial statements of the company have become overwhelming in the last decade. Personal gain

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<sup>712</sup> Adeyemi, S.B. (2004) 'Ministration of Financial Crime: The Role of Accountant', 1 *Student Accountant Journal*, 7-13; Ajobolave, S. O. (2008) 'A Survey of the Perception of Ethical Behaviour of Future Nigerian Accounting Professionals', 43(3)*The Nigerian Accountant*, 54-59; Bakre, O.M. (2007) 'The Unethical Practices of Accountants and Auditors and the Compromising Stance of Professional Bodies in the Corporate World: Evidence from Corporate Nigeria' 31(3)*Accounting Forum*, 277-303.



owing to professional misconduct has clearly preceded the need to act in public interest.<sup>713</sup>

Notwithstanding the limitation of audit firms in Nigeria, auditing firms are known to provide a combination of audit and non-audit services which is a clear breach. However, while it is as would be later revealed, Akintola Williams Deloitte were auditors for three of the big five, namely Finbank, Afribank and Union Bank, while PricewaterhouseCoopers audited Oceanic Bank and Intercontinental Bank.

It should be mentioned here that after the post-consolidation exercise, only these four audit firms were responsible for auditing all the five banks and as such there is oligopoly. In the case of the two audit firms responsible for conducting audit of the five banks, they actually had the responsibility of auditing a total of eighteen banks between them having been engaged by these banks and this would mean intense competition among them. Not only has audit oligopoly in Nigeria created income stability, but it has also opened the door for provision of other non-audit services because it is almost considered normal for the same firm to provide both audit and non-audit services, despite the fact that the 2006 Code which in effect, prohibits the provision of NAS. With income running as much as millions of Naira, stakeholders are therefore left with no clue as to checking the quality and standard of these audits.

As noted by Cousins et al:

‘In the absence of a ‘duty of care’ to individual stakeholders and public accountability, the auditing industry does not have strong economic incentive to improve the quality of audits. If by hook or by crook a company survives, no external party knows that audits

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<sup>713</sup> Bakre, O.M. Ibid, 286.

were botched. Anyone hiring a solicitor has full access to that solicitor's working papers, but there are no equivalent rights for anyone hiring an auditor. The auditing industry is pre-occupied with fees and client appeasement... The auditing firms blame others for being the targets of lawsuits but show no signs of looking at how their own values and working practices contribute to poor audits.<sup>714</sup>

The authors further argued that in the wake of audit commercialisation, auditing firms are more drawn to mechanical compliance with professional auditing standards rather than audit quality and independence, and lot of effort is put into hiding loopholes and irregularities.

The table below shows the auditors of the top five banks to illustrate the particulars of their audit.

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<sup>714</sup> Cousins J. Mitchell, A., Sikka, P., Willmott, H. (1998) 'Auditors: Holding the public to Ransom' *A monograph by the Association for Accountancy and Business Affairs*, Basildon: Basildon, UK. p.9

**Table 5**

Bank	Year end	Auditor	Date of last Audit report	Audit Opinion	Auditor's Remuneration (N millions)	
					2008	2007
Intercontinental	29/02/2008	PwC	May 2008	Unqualified	208	112
Oceanic Bank	31/12/2008	PwC	May 2009	Unqualified	168	100
Union Bank	31/03/2009	AWD, BTN	Oct. 2009	Unqualified	118	113
FinBank	31/04/2008	AWD, AI	Dec. 2008	Unqualified	67	63
Afribank	31/03/2008	AWD	Mar. 2008	Unqualified	N/A	N/A

Source: Adesanya and Lauwo<sup>715</sup>

Although Adesanya and Lauwo do not explicitly state in the table whether the auditors' remunerations were for provision of both audit and non-audit services, it is implied that this was the case because as will be seen by Union Bank later, their remuneration included both audit and non-audit services which they stated in their report.

As illustrated from the table above, each of the banks had unqualified audit reports immediately prior to their financial distress which was discovered by the CBN. The ridiculous amount of their fees suggests that the auditors and the banks are too close for comfort. In 2007, the Nigerian Deposit Insurance Corporation (NDIC) annual report had shown signs of insolvency among Nigerian banks whereby out of the 24 banks that existed in the country at the time, only four were sound, yet audit reports of the banks showed that

<sup>715</sup> Otusanya, J. O. and Lauwo, S. (n.654), 187

<sup>715</sup> Ibid

the majority of the banks were sound when in actual fact 17 banks were fair, two were marginal and one was unsound.<sup>716</sup>

As earlier examined in this chapter, it is a legal requirement that auditors must provide a written report stating whether the financial statements of the company reflect a true and fair view of the company's financial status and their profit and loss accounts and balance sheets have been prepared up to standard. However, upon investigations in 2009, it was discovered that the banks had received unqualified reports from their auditors. The auditors had expressed no opinion as to the value of non-performing loans or any irregularities that could have revealed signs of distress in these banks. Shortly after, the CBN announced that these banks had financial distress.

Accounting Standards require auditors to consider the ability of an entity to continue in operational existence as a going concern for the foreseeable future and this would ordinarily mean that the auditor makes an opinion on both present and future circumstances in which the entity operates.<sup>717</sup> Surely it can be argued on the one hand that the auditors are not saddled with the responsibility of anticipating crisis in these banks; it can also be said that having been forewarned by the NDIC on the activities of these banks, perhaps a more in- depth investigation of their accounts by the auditors may have revealed this distress or, in a situation where control fraud prevents the auditor from conducting appropriate and necessary further investigations, and in a situation where all efforts to access documents that could lead to further investigations was jeopardised, perhaps a statement pointing this out and expressing dissatisfaction in the accounts in the audit report could have relieved them of any potential public doubt.

Furthermore, while it may be practically impossible for auditors to anticipate the problems in these banks, such as the continuous use of the

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<sup>716</sup> NDIC Report, 2007. [http://ndic.org.ng/files/2007\\_annual\\_report.pdf](http://ndic.org.ng/files/2007_annual_report.pdf) accessed 1 August, 2013

<sup>717</sup> NSA 23(n.676) Para. 6-10 on Going Concern

discount window, it is important that they pick on the persistent use of the discount window in the financial statements of the banks and should raise concern for this in their report. Perhaps if concerns were raised, it might have relieved them of any doubts that later came to the mind of the people, particularly the CBN on their credibility. It is also important to state that it may be impossible to know for certain the actual documents provided for the auditors to which their opinions were based. This is due to the problem of poor record-keeping in Nigeria. Efforts to gather information on the documents presented to the auditors upon which their reports were based proved abortive, with most of the banks now merged and records are either lost or withheld for whatever reason.

In the case of Oceanic bank Plc, the auditors were reported to have asserted that:

‘We have audited the accompanying consolidated financial statements of Oceanic Bank International Plc (“the Bank”) and its subsidiaries (together, “the Group”) which comprise the consolidated balance sheets as of 31 December 2008, consolidated profit and loss accounts and consolidated statements of cash flow for the year then ended and a summary of significant accounting policies and other explanatory notes.... In our opinion, the consolidated financial statements give a true and fair view of the state of financial affairs of the Bank and Group as of 31 December 2008, and of their losses and cash flows for the period then ended in accordance with Nigerian Statements of Accounting Standards, the Companies and

Allied Matters Act and the Banks and Other Financial Institutions Act.<sup>718</sup>

Investigations of the CBN on Oceanic Bank suggested a contrary view on the quality of the audit report and also the credibility of the auditors particularly on the issue of failure to disclose the level of non-performing loans of the bank. Oceanic banks annual report for 2008 shows it had N36 billion (\$288million) non-performing loans. However, in 2009, the CBN declared that the bank had a total of N278.2billion (\$2.2billion) non-performing loans which represents about 37 per cent of the total non-performing loans of the five distressed banks which was put at N747billion (\$5.98billion).<sup>719</sup>

Similarly, in the case of Intercontinental Bank, the audit report also conducted by PricewaterhouseCoopers had shown non-performing loans of N16.6billion (\$132.8million) where the CBN had revealed a total of N210.9billion (\$1.69billion) of non-performing loans which accounted for about 28% per cent of the total non-performing loans.<sup>720</sup>

The other three banks, namely Afribank, Union Bank and Finbank, Akintola Williams Deloitte (AWD) had served as auditors for them.<sup>721</sup> Union bank had reported in its annual report in 2009 that the joint auditors, AWD and BTN had received N146million (\$1.17million) for audit and accountancy (non-audit) services.<sup>722</sup> The disclosure of Union Bank in their annual report to indicate how much they got for non-audit services will suggest that they provided NAS for the other two banks that they audited which are FinBank

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<sup>718</sup> Oceanic Bank audited report. <http://www.scribd.com/doc/33417972/Oceanic-Bank-International-Plc-Audited-Financial-Statement-for-Period-ended-December-31-2008> accessed 5th June, 2012

<sup>719</sup> Ibid

<sup>720</sup> Otusanya and Lauwo (n.654) 188

<sup>721</sup> Although two of the banks had been jointly audited with other auditors. Union Bank was jointly audited by AWD and Baker Tilly Nigeria (BTN) and Finbank was jointly audited by both AWD and Aminu Ibrahim &Co Auditors (AI)

<sup>722</sup> Union Bank annual report available at <http://resourcedat.com/blog/2010/12/24/bank-annual-reports-2009/> accessed 2<sup>nd</sup> August, 2012

and AfriBank, and may also lead to suspicions that PwC must have done the same for the remaining two banks, that is, Oceanic and Intercontinental banks. The result, no doubt had been good value for money where the audit report had stated that the bank was financially sound. However, in the same year, the bank was declared distressed by the CBN.<sup>723</sup>

Perhaps one case, which is not surprising after all, is that of Afribank. This is so because in 2006, AWD had been indicted for facilitating the falsification of the 2006 accounts of Afribank Plc having been exposed by the former Managing Director, Mr. Patrick Olayele Akinkuotu. It was alleged that both the audit committee of the bank and AWD had colluded to manipulate the company's accounts to reveal a pre-tax profit of N3.69billion, total assets of N131.2billion and shareholders fund of N27.06billion.<sup>724</sup>

Investigations by the management discovered a loss of N6.9billion after tax, total assets of N127.5billion and shareholder fund of N17.85billion compared to the 2005 amount of N21.4billion.<sup>725</sup> It was also discovered that one of the reasons for the difference in the management figures and the audited figures was as a result of huge non-performance risk assets which had been intentionally brought forward from the previous year as performance risk assets. The controversy became aggravated when it was discovered that the CBN had indeed certified the audit as being satisfactory and had given it a clean bill of health. The CBN, upon public demand commenced re-investigation of the bank accounts while the Nigerian Stock Exchange as well as the House of Representatives Committee on Capital Market also launched a separate investigation.

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<sup>723</sup> The activities of the CBN and their findings was be discussed in detail in chapter six on CBN

<sup>724</sup> Afribank: <http://grandioseparlor.com/2006/10/nigerian-super-banker-whistles-fraud-cover-up-at-afribank/>

<sup>725</sup> Ibid

AWD however, denied their involvement in any unethical auditing practices and was observed to have noted:

‘In our thirty years of experience, this is the first time someone would accuse us of modifying our report. We apply the rule 100 per cent, we do not bend the rules at all. Our firm has a world renowned in-house audit approach called Deloitte audit and accounting standards both local and international.’<sup>726</sup>

However, while the investigations were still ongoing, AWD was implicated on another financial falsification involving Cadbury Nigeria Plc, a subsidiary of Schweppes Overseas Limited. It was alleged that the financial falsification was a collaborative act by AWD and the MD/CEO, Bunmi Oni and the Finance Director, Ayo Akadiri, who was a chartered Accountant and member of ICAN. Cadbury Nigeria Plc was quick to refute these allegations and employed another audit firm, PricewaterhouseCoopers (PwC) to conduct an independent audit of the firm. This then necessitated the involvement of the Securities and Exchange Commission (SEC) which launched its own investigations and the issues for determination included inadequate disclosure and non-compliance with Corporate Governance Codes, deteriorating cash flows, declining profitability, worsening leverage flow and obtaining loans for the payment of dividends to shareholders.<sup>727</sup>

Consequently, the directors and management were invited for questioning regarding violations of the provisions of the Investments and Securities Act, 1999, the SEC Rules and Regulations 2000 (as amended), the Code of Conduct for Capital Market Operations and their employees as well as the Code of Corporate Governance of Nigeria. The Commissions

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<sup>726</sup> Otusanya and Lauwo (n.654) 179 (referring to *ThisDay* 16 October 2006)

<sup>727</sup> SEC Releases Final Decision:

<http://www.proshareng.com/article/1495.html> accessed 22nd September, 2013.



Administrative Proceedings Committee (APC) was particularly interested in AWD as external auditors involved in two ongoing scandals at the time.

The investigation, which was concluded in March 2008, revealed a number of findings, especially on the involvement of AWD in the companies involved. Specifically, APC found that:

‘Professional scepticism generally requires that an auditor should not believe documents presented by a client till it sees evidence that they are genuine. In the company’s case, AWD did not probe any further or doubt documents presented by the company in spite of the internal control lapses detected and revealed in the management letters. AWD and in particular the partners that handled the company’s account, did not carry out their assignment with high level of professionalism and diligence expected of a reputable accounting firm of its calibre.’<sup>728</sup>

It was also found by the commission that the companies had filed annual report and accounts which contained mis-statements, that the completed audit report of PWC which was submitted to SEC revealed a mis-statement of approximately N13billion for the companies as at September 2006 and both the company directors, auditors and persons in charge of and responsible for the financial documents were liable. Consequently, the Managing Director, Bunmi Oni and the Finance Director, Ayo Akadiri were banned from operating in the Nigerian Capital Market and holding directorship positions in any public company in Nigeria, and their names were passed to the Economic and Financial Crimes Commission (EFCC). AWD was also ordered to pay a fine of N20 million.<sup>729</sup>

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<sup>728</sup> Ibid

<sup>729</sup> Ibid

The problem with Afribank plc would lead to a lot of suspicions, not only on AWD but on the other auditors responsible for the five banks. Is the fine enough? Although AWD was reprimanded and ordered to pay a fine, banning the said directors from operating in the Nigerian Stock Market and being Directors of any public company in Nigeria seems fair, but is it adequate enough to prevent others from doing same? It is summated that the fine is not proportional to the level of damage caused which was merely labelled as negligence and unprofessionalism.

Perhaps the fact that they could get away with it was why they did it again during the periods that led to the crisis. Although the auditors could always claim that they were ignorant of the activities of the CEOs and merely did their job based on documents provided to them, but it has been established earlier that they must have been aware of the financial problems in the banks, at least due to previous concerns raised by the NDIC.

Furthermore, in a society like Nigeria where corruption is endemic, it is impossible to say for certain that auditors are actually independent. The average business activity in Nigeria is potentially suspicious. According to Okike, in Nigeria, lack of checks and balances, coupled with poor national integrity is almost institutionalised, therefore creating doubt as to the independence of auditors.<sup>730</sup> According to Otusanya, AWD was seen as auditor, stock market consultant and tax manager.<sup>731</sup> This increased commercialisation of auditors may have resulted in auditors being sold as 'lost leaders' in the bid to sell more profitable services; this money driven motive sees audit services as a means to an end; that is, access to senior management positions, thereby creating room for more consultancy

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<sup>730</sup> Okike, E. N. (2007). 'Corporate governance in Nigeria: The status quo.' 15(2) *Corporate Governance: An International Review*,173-193.

<sup>731</sup> Otusanya and Lauwo (n.654) 183

services.<sup>732</sup> In this regard, Nigerian Auditors are considered by Otusanya as ‘the private police force of capitalism’.<sup>733</sup>

## **7.8 Audit Failure in Nigeria: An institutional Problem?**

### ***7.8.1 Control Fraud***

The concept of control fraud has been examined in detail in chapter three on CEOs. However, having uncovered the involvement of auditors in the banking crisis, it is important to determine their role in control fraud, as it is an important question central to this thesis.

As financial super-predators, control frauds are skilful in identifying both human and regulatory weakness. In the case of the top five banks in Nigeria, it can be seen that at least one clean external audit opinion was obtained by each of these banks. It therefore follows that auditors, both internal and external, may be valuable accessories to control frauds. Although what remains unclear is how to determine the actual involvement of auditors in control frauds, in the case of Afribank above, the auditors were found guilty and liable for fraud, AWD was found to be complicit in the fraud but yet, allowed to get away with it the first time by ‘strongly reprimanding’ them and this explains why they could do it again.

On the one hand, for external auditors whose responsibility it is to make a report as to whether the statements presented before them actually reveal the ‘true’ and ‘fair’ state of affairs of the company, it becomes difficult to prove that they may have indeed been helpful in manipulating the accounts as he can then bring up the defence of ignorance, however untrue, claiming that all information and investigations were verified and appeared correct at the time. On the other hand, the internal audit committee whose job it is to prepare these statements in the first place may contribute to control fraud

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<sup>732</sup> Ibid 189

<sup>733</sup> Ibid

whereby the CEO, as the person ultimately in ‘charge’ of the company, could influence and turn them into accessories. Therefore, a carefully manipulated account could be presented to an independent external auditor, who is then misled to provide a ‘clean bill of health’ for the bank, thereby causing shareholders and the investing public to believe in the viability of the bank whereas the reverse is the case. The point here is that auditors can be used as a contributory tool for control fraud because their opinion as provided in the audit report is very important to the financial status of the company. It can therefore be said that auditors can contribute to control fraud.

Furthermore, Black examines opportunistic control fraud. This type of control fraud examines a wave of frauds whereby opportunists seek out the best field for fraud. To this end, four factors are crucial: ease of obtaining weak control, weak regulations, ample accounting abuses and the ability to grow rapidly.<sup>734</sup> He explains this further by positing that companies with weak rules against fraud are likely to invite abusive accounting practices. These companies with abusive accounting practices have higher opportunities for growth due to their constant production of fictitious profits, misleading investors and creditors to invest in the control fraud. Opportunistic control fraud makes regulatory and business environments ideal for fraud. In the case of AWD, they saw the opportunity to utilise the totality of weakness in the system to continue with these frauds, and of course, mention must be made that this was done in collaboration with the CEOs, leading to a web of frauds. Furthermore, little or nothing was done by ICAN to bring the auditors to book by prosecuting them in the first place, leaving a possibility that they could get away with it a second time, which frankly speaking is the case, as the auditors still work and live as free persons to date.

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<sup>734</sup> Black, W. K. (2005) *The Best way to rob a bank is to own one* Texas: University of Texas Press, 7

In view of the above, it can be said that control fraud was a major contributor to audit failure in Nigeria because the corporate environment and indeed all spheres of the economy were the best in the country for opportunistic fraud at the time, and it is no wonder that the control frauds caused so much damage at the time.

### **7.8.2 *Regulatory Failure***

In Nigeria, what should have been audit quality has been overshadowed by politics, power and social connections. Notwithstanding the fact that the need for audit quality and objectivity is being stressed by regulatory bodies and contained in various auditing standards, as in any other company, auditors are individuals under the pressure of financial performance, which would mean appraisals, promotion and fat packages.

Furthermore, it goes without saying that professional regulators have erred in the sanctioning of their members and exercise of their statutory obligations. Former National President of the Association of National Accountants of Nigeria (ANAN), Samuel Nzekwe, has argued that the banking crisis had exposed ICAN as its members were involved in accounting mis-statements and although ICAN had claimed through the Vice President at the time that it did all it could to discipline its members, details of what was done remains unknown and certainly this is misleading as there is no record of any proceedings against them.<sup>735</sup> Going further, he posited that the problem does not lie in provision of new rules dealing with erring bank officials or auditors, the problem however lies in appropriate bodies enforcing the rules in place as none of the auditors who were implicated were actually prosecuted by their own regulatory bodies.<sup>736</sup> While it is agreed that Nzekwe is right in identifying the problem as that of enforcement, it is however important to state that it is not only the job of

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<sup>735</sup> Otusanya and Lauwo (n.654) 193-194

<sup>736</sup> Ibid. Although they were fined by SEC, the ICAN failed to discipline the firm.

regulators to implement enforcement. As will be stressed throughout the course of this thesis, enforcement is most likely to work if all participating bodies in corporate governance work together to promote effective corporate governance.

As noted by Bakre, the fact that the auditors were implicated in the fraud should call for concern from their regulatory bodies, they should have conducted investigations within their power to probe the auditors; however, the accounting regulators have used their power and privileges to shield their members from being held accountable.<sup>737</sup>

Also, the then Chairman of the Economic and Financial Crimes Commission (EFCC), Farida Waziri, was noted to have stated:

‘During our investigations, we found that all the erring bank chief executives were given a clean bill to operate by both the external and the internal auditors who are paid to do so. It was gathered that these auditors connived with the chief executives to cook the books and cover the tracks while the frauds were being perpetrated.’<sup>738</sup>

It is important to state that the EFCC is a criminal organisation aimed at prosecuting members of the public or companies alleged with financial misconduct. It is interesting to see that having made the above statement; the EFCC has failed to prosecute any of the auditing firms alleged to have been involved in the fraud. It is therefore absurd that only the CEOs were further indicted and actually charged with fraud when it is clear from the statement of the EFCC that their investigations revealed that the auditors were ‘*paid*’ by the CEOs to give their financial statements a ‘clean bill’.

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<sup>737</sup> Bakre, O.M. (n.712)

<sup>738</sup> Otusanya and Lauwo (n.654) 189

Clearly, as explained earlier in the chapter, the limitations of audit as a task itself would suggest obscurity as to what is expected of an audit and what audit actually produces, it could also be the case that auditors might be victims of control fraud, having absolutely no knowledge of what goes on behind closed doors; however, this is not the case of the auditors of these banks, as the EFCC had actually confirmed collaboration and conspiracy between these auditors and the CEOs but sadly none of these auditors have been indicted. It can be said that the auditors were actually complicit in the fraud as will be discussed shortly. The public was led to believe that drastic steps were being taken to bring the culprits to book. However, while this can be said of the CEOs and members of management staff and internal audit committee that were involved, very little can be said of the prosecution of the external auditors involved in the crisis. What the Regulators and EFCC have done is to invite the indicted auditing firm from time to time for a hearing without any further prosecution.

It is evident that the activities of the auditors would require statutory obligations from the professional bodies to conduct an investigation and provide appropriate sanction for its members. It is important to state here that the disciplinary tribunal of ICAN has the status of a federal high court.<sup>739</sup> However, to date, the involvements of audit firms in the banking crisis have not been investigated by their ICAN, neither has it indicted any of its members. However, what we see is a situation where power and privileges of self-regulatory status of ICAN have been utilised to shield these auditors from public accountability. The issue that comes to mind at this stage is whether the capitalist nature of these accountants creates a pressure to make profits and therefore an avenue for auditors to engage in

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<sup>739</sup> From the Disciplinary Tribunal, a member has a right to appeal to the Court of Appeal. (Institute of Chartered Accountants of Nigeria, Professional Code of Conduct and Guide for Members, 2009, s. 21.2.7.); Section 12(5) of the Institute of Chartered Accountants of Nigeria Act No 15 of 1965 See also the establishing clause in the Preamble to the ICAN Act

unethical practices. Perhaps the reason for this is not farfetched as will be explained below:

In Nigeria, whereas directors and bank executives were held accountable for fraudulent and corrupt practices, the position is massively different for auditors where auditors cannot be held personally liable for fraudulent practices. Auditors have therefore remained questionably silent in commenting on the activities that led to the crisis. Therefore, in arraiging the bank executives, the Economic and Financial Crimes Commission (EFCC) had merely invited the audit firms for hearings without penalising them for their unethical practices and their contributory role in financial misappropriation. The lack of power to personally prosecute the auditors involved calls for concern. Perhaps a reform is necessary in this area of corporate governance, that auditors should be held personally liable for fraud.

### ***7.8.3 Audit Oligopoly: Too close for comfort?***

Issues of corporate governance failure due to unethical practices, professional pressure, politics and power undermine the objective of auditing and this should be a major concern for regulators. It can be rightly said that carrying out investigations and extra audits only when issues of financial distress due to misappropriation spring up suggests that the auditors' role have been compromised and questions the quality and independence of auditors.

From the case studies above, it can be seen that the five banks were audited by two main audit companies. The oligopoly of audits in Nigeria would lead to a lot of concerns especially on the issue of independence. It should be noted that at the time of the crisis, although there were more than four accounting bodies in Nigeria, banks were attracted to the leading ones; perhaps, due to their international affiliations. In Nigeria, notwithstanding



the fact that nomination and appointment of audit firms is determined at annual general meetings, auditors are actually dependent on directors for their appointment and remuneration as provided in CAMA and as such, they would want to keep them on their side so as to secure further appointments.

The variety of services provided to the client, an auditor-client relationship is developed which would mean a compromise of professional independence and audit quality. In Nigeria, the provision of CAMA regarding Auditor Tenure policy is an open-ended one which would mean that Auditors can be re-appointed as many times as possible inasmuch as they are approved by the General meeting. In order to constantly gain re-election as Auditors, it would follow that Auditors would be willing to establish sound relationships that would not put their job in jeopardy.

In Nigeria, concerns regarding corporate governance standards for auditors, particularly audit quality and independence have raised a lot of attention. As earlier stated, in the wake of the banking crisis, shareholders have blamed both auditors and the audit committee for misguiding them as to the financial situation of the banks. Auditor-client relationship includes emotional, financial and personal interests; auditors may therefore favour their self-interest in the performance of their duty. Freedom from bias and prejudice is crucial to auditor independence, to the extent that auditors must have no personal interest in the company; neither should they be susceptible to any form of bias or influence.<sup>740</sup> Questions have been asked as to the negligence and compromising nature of the auditors in the discharge of their duties. Perhaps the development of personal relationship between auditors and their clients has put the auditors in a tight situation where they would not want to 'bite the finger that feeds them'. Audit oligopoly is a recurring issue of audit quality in Nigeria owing to longstanding relationships.

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<sup>740</sup> Firth, M.(2002) (n.701)

Perhaps a good suggestion on promoting auditor independence would be rotation of auditors, practiced in western economies.<sup>741</sup>

## **7.9 Conclusion**

This chapter examined the role of auditors in the banking crisis, taking into account the big five banks. The chapter aimed at investigating contemporary auditing in Nigeria and its adequacy or otherwise in preventing the soon revealed cases of control frauds.

Although audit is a risk reduction exercise and the label ‘audit’ plays an important role in different organisations including banks, audit can be said to be a rigorous exercise on its own, a responsibility with too much expectations, at the expense of the auditor. It can be said that the responsibility of producing audit assurance in a society where control fraud is apparent is limited by the obscurity of audit actually is, what audits can and cannot do, and more often than not, the question of failure is highly contested.

Notwithstanding the above limitations, it can be said that the lack of independence for auditors in Nigeria is guided by a deeper problem of corporate governance failure and also institutionalised corruption, which has become endemic in Nigeria.

Freedom from bias and prejudice is crucial to auditor independence, to the extent that auditors must have no personal interest in the company; neither should they be susceptible to any form of bias or influence.<sup>742</sup> Questions have been asked as to the negligence and compromising nature of the auditors in the discharge of their duties. Perhaps the development of personal relationship between auditors and their clients have put the auditors in a tight situation where they would not want to ‘bite the hand that feeds

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<sup>741</sup> For instance in the UK where auditors are being rotated round companies.

<sup>742</sup> Firth, M. (2002) Ibid

them'. Audit oligopoly is a recurring issue of audit quality in Nigeria owing to longstanding relationships.

In Nigeria, the provision of CAMA regarding Auditor tenure policy is an open-ended one and by Section 357, auditors can be re-appointed as many times as possible inasmuch as they are approved by the General meeting. In order to constantly gain re-election as Auditors, it would follow that Auditors would be willing to establish sound relationships that would not put their job in jeopardy.

According to Patrick Gaye:

‘There is no way the auditors especially the external auditors could have done what is expected of them because, the external auditors in particular, are just like contractors who dance to the tune of their hirers. Auditors are on a retainership and for the banks to retain them on the job; they would not want to rock the boat through exposing the banks’ shortcomings to the regulators’.<sup>743</sup>

Furthermore, prior the banking crisis, various provisions have now been made to limit the tenure of auditors. According to Section 8.2.3 of the Code of Corporate Governance 2006, the tenure of external auditors shall be for a maximum number of ten years after which the audit firm shall not be permitted to be reappointed by the bank until a further period of ten years. Likewise, the ICAN Code of Conduct and Guide for Members (2009) also noted that constant re-election may lead to an auditor being too over-influenced by the directors and management of the company to the point of being too sympathetic to his detriment.<sup>744</sup>

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<sup>743</sup> Otusanya and Lauwo (n.654) 191 (Referring to Patrick Gaye in *The Guardian* , 30 August 2008)

<sup>744</sup> ICAN Code of Conduct, 2009, s.3.6.9

However, while the Code of Corporate Governance sets a ten year limit of audit tenure, the ICAN Code of Conduct prescribes a five year limit according to Section 16.3.0, after which the auditor must cease to be engaged for another period of five years before he can then commence to work for the firm.<sup>745</sup> However, a controversial clause is further provided in the Section, which provides that the auditor is not precluded from engaging in ‘other forms of involvement’ with the client. Clearly, if after serving as auditor for five years, the same auditor is still involved in other forms of involvement with the bank during the five year cooling off period, the whole point of auditor rotation is jeopardised. Furthermore, there is no indication regarding the sort of involvements that were allowed in these sections and whether provision of non-audit services could be construed here; to which case, the provisions of CAMA and BOFIA discussed above would preclude an auditor who had been involved in any other engagement with the client from serving as auditor, therefore the auditors would be disqualified from any possible future engagement after the five years. Perhaps, this clause has been constructed by ICAN for the benefit of its members and ultimately itself.

The problem here does not lie on lack of adequate corporate governance regulation as it would be gathered from the above discussion that there exists adequate legal responses to financial auditing in Nigeria with provisions to cover audit quality and independence, audit tenure as well as provision of non-audit services. In fact the new provisions following the crisis as seen above would merely create more controversy as to what auditors should and should not do. The problem however, lies in enforcement. Clearly the 2006 Code lists the type of services prohibited from auditors and these are clearly breached. It therefore becomes important to ensure that the rules in place are adequately enforced. This will lead to the suggestion that non-audit services should be more clearly catered for.

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<sup>745</sup> Ibid. S.16.3

Furthermore, another feasible suggestion would also be to strengthen enforcement mechanisms by placing both auditors and directors on the same platform with regard to prosecution for fraudulent financial activities. The implementation of legal sanctions against auditors found guilty of financial mis-statements would serve as a deterrent for others to learn from. Again, it should be mentioned that the problem of control fraud in Nigeria clearly goes beyond strengthening enforcement mechanisms for auditors alone, but a targeted effort to reduce fraud in Nigeria should be the responsibility of all corporate participants. This suggestion on enforcement is vital to this research as a whole and would be further developed in the course of this thesis.

That notwithstanding, another issue that remains frustrating is the fact that to date, the CBN fails to produce details of its 'Special Investigation' of these banks, despite repeated demands by the public, shareholders and the House of Representatives. What is seen instead, are references made to these reports, publications and statements in newspapers revealing that the results of their special investigations reveal evidence of fraud and accusing the CEOs and auditors of financial mis-statements.

## **Chapter 8**

### **An Investigation of the role of Shareholders in Control**

#### **Fraud: Evidence from the banking crisis\***

##### **8.1 Introduction**

The chapter critically investigates the role of the shareholders in control fraud. In view of the provisions of the laws and the codes of corporate governance, the chapter will determine whether issues of negligence, complicity or collusion can be said to have encouraged the fraud. Of particular importance is the active involvement of majority shareholders in contributing to the bank fraud, or the effect of executive directors of these banks also who owned shares in the banks and could therefore take advantage of their shareholding power to manipulate the bank to their advantage due to their power and status. The impact of political patronage through government shareholding would also be considered. More so, shareholder activism in Nigeria, through the existence of shareholder association, will be examined and analysed to determine whether during the banking crisis of 2009, there was enough shareholder activism in the country. Particularly, in helping to prevent the crisis or protect the rights of shareholders after the crisis. Mention must be made that efforts to collect data on the shareholding composition of each of these banks have proved abortive. This is due to the lack of adequate record-keeping in Nigeria, coupled with the fact that many of these banks have been merged and therefore relevant documents are no longer available to the public. Perhaps the lack of available documents is also due to the circumstances surrounding their mergers.

## 8.2 Separation of Ownership and Control

Jensen and Meckling define agency relationship as a contract whereby one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision-making authority to the agent.<sup>746</sup> The principals are identified as Shareholders while the Directors are Agents. If both parties to the relationship are utility maximisers, there is good reason to believe that the agent will not always act in the best interests of the principal.<sup>747</sup> They further examined the ownership structure of a corporation, taking into account how equity ownership by managers can be said to combine their interests with that of the shareholders.<sup>748</sup>

According to them, the principal is able to limit divergences from his interest through monitoring costs and the creation of various incentives aimed at limiting future deviant activities of the agent.<sup>749</sup> Monitoring costs are usually undertaken by shareholders up to the point that these do not exceed agency costs they are aiming to control. For example, providing bonding costs (such as advertising costs that results in attracting more external scrutiny to the firm thus reducing agency costs) for the agent to guarantee that he will not harm the principal, and where this happens,

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\* It is important to state that an abridged version of this chapter has been published. See Iyaniwura, W., Iyaniwura, S. (2014) 'The Nature of Shareholding in Nigeria: Evidence from the Banking Crisis.' 14(5) *Global Journal of Management And Business Research*, North America

<http://journalofbusiness.org/index.php/GJMBR/article/view/1345> accessed: 10th January 2015

<sup>746</sup> Jensen, M and Meckling, W. (1976) 'Theory of the Firm: Managerial Behaviour, agency costs, and ownership structure. 3 *Journal of Financial Economics* 305-60

<sup>747</sup> Ibid 310. It can be said that agency theory developed within economics and has since served as a foundation for most scholarly research in corporate governance and provided foundation for a more powerful approach to theories of corporate governance. Monks, R.A.G and Nell Minow, N. (2001) *Corporate governance - 2nd ed.* Oxford: Oxford Blackwell Business, Eisenhardt K.M. (1989) 'Agency Theory, An Assessment and Review' *Academy of Management Review* 1457-74, Fama, E.F., Jensen, M.C. 1983. 'Separation of ownership and control' 26 *Journal of Law and Economics*, 301-25, Jensen, M and Meckling, W. (n.429)

<sup>748</sup> Jensen, M and Meckling, W. (n.746)

<sup>749</sup> Ibid 310.

ensuring that the principal is compensated. However, more often than not, there will be a discrepancy between the agents' decisions and decisions that would serve to optimize the interest of the principal. This is because it is generally not feasible for either the principal or agent to ensure that the agent will make vital decisions in the interest of the principal at no cost; generally, monitoring and bonding costs are usually incurred.<sup>750</sup>

Agency costs are defined by Jensen and Meckling to include monitoring expenditures incurred by the principal, bonding expenditures incurred by the agent, as well as residual loss.<sup>751</sup>

Going back to Fama and Jensen, organisations that tend to separate residual risk bearing from decision management are generally complex in nature because valuable information is then diffused among many agents of the organisation, therefore what we have in most complex organisations are diffuse decision control systems of formal decision levels where the decision of lower agents (such as managers) are submitted to higher level agents (such as the board of directors), initially for ratification and later for monitoring.<sup>752</sup> This is because where there are many residual claimants, decision control becomes a costly exercise; hence, the need to separate residual risk from decision control. This would then create problems of agency relationship between residual claimants and decision agents. The separation of decision management and control at all stages in the organisation, the incurring of monitoring costs by the residual risk claimers and the bonding costs incurred by the agents would collectively help to

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<sup>750</sup> Otherwise known as pecuniary and non-pecuniary costs. Ibid

<sup>751</sup> It is important to note that monitoring goes beyond measuring and observing the agents behaviour from time to time, it also includes practical efforts of the principal to 'control' the behaviour of the agent, such as operational rules, policies, and the likes. Residual loss refers to agency costs incurred despite appropriate monitoring. See Jensen and Meckling Ibid at p.310-311.

<sup>752</sup> Fama and Jensen (n.747)



reduce possible agency problems by limiting the power of agents to appropriate the interests of residual claimants.<sup>753</sup>

The need to separate decision control and management would be effective in complex organisations as they would both allow relevant applicable knowledge to be utilised as and when due because they help to control the agency problems that are posed by diffuse residual claims. Furthermore, in decision control systems where multiple-member board of directors tend to ratify and monitor important decisions as well as choosing, rewarding and dismissing important decisions that bear little or no share of the cost effects of their decisions, make it difficult for any form of collusion between decision management at the top and control agents.<sup>754</sup> This ultimately facilitates the separation of the management and control of organisations' most crucial decisions.

### **8.3 Nature of Shareholding in Nigeria**

The Federal Republic of Nigeria is a former colony of Britain. The first companies to operate in Nigeria were therefore British companies chartered in England. Foreign companies had foreign ownership status that granted them absolute rights and privileges associated with it. Legal activities began in 1876 when Lagos, the then Federal Capital Territory, was ceded to the British Crown. Following the amalgamation of the Northern and Southern protectorates in 1914 and the establishment of a Supreme Court for the whole country, an Ordinance was also promulgated for the whole country. Section 14 of the new Ordinance provided that: 'subject to the terms of this or any other Ordinance, the Common Law, the Doctrines of Equity and the Statutes of General Application, which were in force in England on the 1<sup>st</sup> of January 1900, shall be in force within the jurisdiction of the court.'

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<sup>753</sup> Jensen and Meckling Ibid 310

<sup>754</sup> Ibid

The above provision laid the foundation of Company Law in Nigeria as the English Common Law and Doctrines of Equity became applicable to Nigeria. The Companies Ordinance of 1912 was the first Company law in Nigeria, based on the English Companies (Consolidation) Act of 1908.

As the most populated country in West Africa with natural resources ranging from crude oil to agriculture,<sup>755</sup> the independence of Nigeria in 1960 necessitated the need for local control of public infrastructure. In this regard, the government effected a major change in ownership and control structure of Nigerian corporations prohibiting absolute ownership by foreign investors.<sup>756</sup> The activities of the government in the encouragement of local participation in economic activities led to the enactments of various Acts from 1962 to 1977. Two major legislations passed to this effect were the Foreign Exchange Act of 1962 known as the FX Act and the Nigerian Enterprises Promotion Decree (NEPD) No. 4 of 1972, also known as the Indigenisation Decree. The purpose of these Acts was to reserve for Nigerians those areas where they had the experience and capital to run. The FX Act prohibited the transfer of security or interest of security outside Nigeria without the permission of the Minister of Finance. The NEPD on the other hand, in a bid to restrict foreign ownership, created three types of enterprises.<sup>757</sup>

First, there were enterprises exclusively reserved for Nigerians, which basically was a reflection of the Nation's economic, financial and corporate needs at the time. There were also enterprises in which Nigerians were not allowed to own more than 40% of shares, in which case foreign companies had the opportunity to invest in the country, generating foreign capital and

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<sup>755</sup> The 2009 estimates revealed that the country's total population is in excess of 154 million, The Nigerian economy is largely based on Oil production which accounts for about 80% of its Gross Domestic Product and more than 90% of its exports.

<http://www.Mbendi.com.energysector.html> accessed 6<sup>th</sup> August, 2013

<sup>756</sup> Boniface Ahunwan (2002) 'Corporate Governance in Nigeria' 37 *journal of Business Ethics* 269-287

<sup>757</sup> NEPD, 1972 s. 4-6

managerial expertise for Nigeria. The third sector was enterprises in which foreigners were not allowed to own more than 60% of shares and these included capital-intensive enterprises.<sup>758</sup>

The ownership structure of the country, prohibiting 100% of foreign ownership, made a lot of foreign corporations to divest their shares. However, due to lack of local investment funds at the time, government became the major shareholder of the divested shares, although few local investors bought a small percentage of the shares.<sup>759</sup> Subsequently, the government became actively involved in the production sector of the country, either solely or as joint ventures with the foreign or local investors. In reality, the government policy on prohibition of absolute foreign investment in the country only operated to empower foreign investors as major partners with the government, leaving local investors as the minority. This, no doubt created abuse of minority rights as majority shareholders had control. Conflict between majority and minority shareholders remains a dominant problem of most developing countries with concentrated ownership structure.<sup>760</sup>

Following the independence of the country in 1960, there was the need to provide a wider framework for indigenous companies. A Law Reform Commission was therefore set up to make recommendations on the future of the country's corporate sector while protecting the interest of investors and the nation. The recommendations of the Law Reform Commission led to the introduction of the Companies and Allied Matters Decree (now Act) 1990.<sup>761</sup> Part 1 and 2 of the Act provides that it shall apply to all companies

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<sup>758</sup> Orojo, J. O. (1992) *Company Law and Practice in Nigeria* Lagos: Mbeyi and Ass. Lagos.

<sup>759</sup> Akinsanya, A. A. (1983) *State Strategies towards Nigerian and Foreign Businesses* (in L W. Zartman (ed.). *The Political Economy of Nigeria* New York: Preager, p. 169.)

<sup>760</sup> La Porta, R., F. Lopez-de-Silanes. and A. Shleifer:1996, 'Law and Finance' (National Bureau of Economic Research, Inc.) *Working Paper 5661*.

<sup>761</sup> It can also be rightly said that CAMA is largely based on the UK Companies Act of 1948.

registered under it, all existing companies, all companies formed or incorporated under other enactments and also all unregistered companies.<sup>762</sup>

The Securities and Exchange Commission (SEC) Nigeria is the apex regulatory institution of the Nigerian capital market.<sup>763</sup> SEC has evolved over time from its first establishment as an arm of the CBN in 1962. As an arm of the CBN, it was originally an ad-hoc committee and later became SEC in 1979.<sup>764</sup> One of the key duties of SEC Nigeria is to review the financial health of publicly quoted companies in order to protect shareholders, and ensure compliance with the code of corporate governance and other relevant guidelines.<sup>765</sup>

The Nigerian Stock Exchange (NSE) is licensed under the Investments and Securities Act (ISA) and is regulated by SEC Nigeria. The NSE is one of the largest Stock Exchange Markets in Africa that provides listing and trading services. The NSE also offers market data dissemination services, market indices and much more.<sup>766</sup> The NSE recognises shareholders as valuable co-owners of their respective companies, with rights and privileges as stipulated by law. The NSE serves the purpose of providing professional advice on selection and management of investments. As a portfolio and issuing house, the NSE also assists sponsors of projects to raise funds on the floor of the stock market, trading in shares and stocks for capital market dealers.

The NSE started operations in 1961 where it listed 19 securities for trading. The requirement for shares to be quoted on the market initially received a

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<sup>762</sup> CAMA, 2004, Part 1 and 2

<sup>763</sup> SEC: <http://www.sec.gov.ng/about-us.html> accessed 11th November, 2013

<sup>764</sup> Ibid

<sup>765</sup> Ibid

<sup>766</sup> Formerly known as the Lagos Stock Exchange, the Nigerian Stock Exchange is the second largest stock market in Africa The first being the Johannesburg Stock Exchange (JSE):

<http://www.advfn.com/StockExchanges/about/JSE/JohannesburgStockExchange.html>  
accessed 27th August, 2011

slow response and as at 1970, only 20 companies had their shares quoted on the market, even though there were about 2000 foreign- owned enterprises in Nigeria at the time.<sup>767</sup> However, today there are 260 Securities listed on the Exchange, made up of 10 Government Stocks, 55 Industrial Loan (Debenture/Preference) Stocks and 195 Equity / Ordinary Shares of Companies. The total market capitalization amounts to N875.2 billion.<sup>768</sup> Most of the listed Companies in Nigeria have foreign affiliations that are dispersed across various sections of the economy ranging from Agriculture to manufacturing and services. The largest Plc listed on the exchange, Dangote Cement, has an asset value of \$2.1billion and a Market value of \$12.5billion. Being the most valuable company in Nigeria, it ranks 1,434<sup>th</sup> position in the list of the World's Biggest Public Companies.<sup>769</sup> In Nigeria, it can be said that concentration of ownership in Nigerian banks is presently with majority shareholders.

#### **8.4 Shareholders' Rights and Responsibilities under Nigerian Law**

Shareholders rights and responsibilities are provided for in a number of legal and Regulatory documents in Nigeria. These include the Companies and Allied Matters Act 2004, the Banks and Other Financial Institutions Acts, 1991, the CBN Code of Corporate Governance and the SEC Shareholders' Rights and Responsibilities 2007.

To start with, CAMA describes members of a company as subscribers of the memorandum of a company. Each member of a company with a share capital is deemed to be a shareholder of the company.<sup>770</sup> Under Section 80 of CAMA, to be eligible to be a shareholder of a company, a person must

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<sup>767</sup> Okike, E. N. (2007). 'Corporate governance in Nigeria: The status quo.' 15(2) *Corporate Governance: An International Review* 173-193.

<sup>768</sup> Figures as at 2003. Source: The Nigerian Stock Exchange [http://www.nigerianstockexchange.com/quoted\\_companies.jsp](http://www.nigerianstockexchange.com/quoted_companies.jsp) accessed 6th August, 2011

<sup>769</sup> Forbes: [http://www.forbes.com/global2000/#p\\_144\\_s\\_acompanyRankOverall\\_All\\_All\\_All](http://www.forbes.com/global2000/#p_144_s_acompanyRankOverall_All_All_All) accessed 6 August, 2011

<sup>770</sup> CAMA, 2004, s. 79 (Part iv)

own at least one share.<sup>771</sup> The Securities and Exchange Commission (SEC) defines a shareholder as a person who owns shares in a company, making him a part owner of the company.<sup>772</sup> As a result of these shares, he is entitled to take part in making decisions for the company, as well as have access to management for all transactions of the company and to all information relating to the performance or otherwise of the company.

Companies perform through their shareholders in meetings, board of directors, or through appointed agents or officers. Shareholders' meetings are classed as 'General Meetings' to which all shareholders have the right to attend and vote.<sup>773</sup> This meeting is not limited to shareholders alone, but also includes other authorised persons that are entitled to attend, such as auditors, debenture holders, and directors. CAMA identifies three types of meetings, which are: the Annual General Meetings (AGM)<sup>774</sup>, the Extraordinary General Meeting (EGM)<sup>775</sup> and the Class Meeting (CM).<sup>776</sup> The powers expressly conferred on shareholders under CAMA are exercised during the appropriate meeting. The shareholders in general meetings can take some decisions to control the management of the company, and in furtherance of their duties use the general meeting to ratify the acts of the

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<sup>771</sup> This would mean that not everybody can be eligible to own shares in a company. CAMA, 2004, s.82

<sup>772</sup> Securities and Exchange Commission, "Know your Rights as a Shareholder" Investor Education Series, p.1  
<http://www.fsccc.gov.ng/files/INVESTOR%20PROTECTION-KNOW%20YOUR%20RIGHT.pdf> accessed 30<sup>th</sup> November 2013.

<sup>773</sup> CAMA, 2004, s.213 of the Act

<sup>774</sup> Ibid. S. 213 (1) of the Act provides that the AGM must be held each year, in addition to any other meeting in that year within a company's first 18 months of incorporation, following which it must be held once a year, in not more than 15 months after the last AGM or not more than 6 months after the end of its financial year.

<sup>775</sup> The EGMs are specially convened meetings designed to discuss matters that are too urgent to wait till the next AGM. By Section 215 (2) of CAMA, an EGM may be requisitioned by any shareholder(s) holding at the date of the requisition not less than one-tenth of the paid up capital of the company as at the date of the deposit carrying the right of voting, or in the case of a company not having a share capital, shareholders of the company representing not less than one-tenth of the total voting rights of all the shareholders having at the said date a right to vote at general meetings of the company.

<sup>776</sup> Class meetings refer to meetings held by holders of a particular class of shares, for example income shares, preference shares, etc. and they are basically held with regard to the variation of rights that are attached to the class of shares.

directors which are *ultra vires* the Board of Directors. CAMA specifies the basic rights of shareholders that range from their voting rights during meetings on important decisions on the activities of the company to their rights to sue for dividend payments and bonus shares from their companies. These include: right to attend company meeting and vote in the meeting; entitlement to notice of meeting; right to transfer shares as a personal property; right to receive dividend once it is declared by the board of directors.<sup>777</sup> Other rights include the appointment of members of the audit committee,<sup>778</sup> fixing the remuneration of the auditors,<sup>779</sup> election of directors<sup>780</sup> and presentation of the report of the financial statements by the directors and auditors.<sup>781</sup>

One way through which shareholders can exercise their oversight function is resolutions. CAMA<sup>782</sup> states that a resolution shall be an ordinary resolution when it has been passed by a simple majority of votes cast by members of a company, who are entitled to do so, voting in person or by proxy at a general meeting. A resolution shall be a special resolution when it has been passed by not less than three-quarter of the voting cast by such members of the company. Also, voting can be made in person or by proxy at a general meeting of which 21 days notice has been given, specifying the intention to propose the resolution as a special resolution.<sup>783</sup>

Apart from the CAMA, the Bank and Other Financial Institutions Act (BOFIA) oversees all banks and other financial institutions in Nigeria. It must be pointed out that unlike CAMA and the Corporate Governance Codes (which will be examined shortly), BOFIA does not provide much

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<sup>777</sup> CAMA, 2004, part IV, V and VIII

<sup>778</sup> It is important to mention that the audit committee must be comprised of both directors and shareholders. CAMA, 2004 s. 359 (3).

<sup>779</sup> Ibid s. 361

<sup>780</sup> Ibid s. 248

<sup>781</sup> Ibid s. 334

<sup>782</sup> Ibid s. 233 (1) (2)

<sup>783</sup> See Ibid s.224 on the requirements of voting

insight on Shareholders' rights and responsibilities. While some of the provisions of the Act complement that of CAMA, on issues such as voting rights and accountability of financial reports, the Act fails to provide any specific responsibilities to shareholders, but rather empowers the CBN with sole monitoring, supervision and regulatory powers of banks.<sup>784</sup>

Mention must also be made of the CBN Code of Corporate Governance, 2006. The Code stems from the consolidation exercise of the CBN as well as the need to encourage good corporate governance practices in the country considering the financial scandals around the world at the time.<sup>785</sup> It is important to state that compliance to the Code is mandatory. The CBN recognises a number of factors responsible for bad corporate governance in the country. These include: fraudulent and self-serving practices among members of the board, management and staff, passive shareholders, ineffective board oversight functions, overbearing influence of Chairman/CEO, especially in family controlled banks, and also succumbing to pressure from other stakeholders, particularly shareholders' appetite for high dividends.<sup>786</sup>

To curb the powers of majority shareholders who may also be directors, the Code recognises that non-restrictive (that is, transferrable) equity-holding has been abused by individuals and their family members, as well as governments' activities in the management of banks. But, in view of the country's policy to encourage private sector-led economy, holdings by individuals and corporate bodies in banks should be more than that of governments.

More so, it recognised that individuals who form part of management of banks in which they also have equity ownership have a compelling business

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<sup>784</sup> BOFIA, 2004 Ss.10, 24, 25, 27.

<sup>785</sup> These include the Enron scandal in USA, the BCCI in the United Kingdom and the Parmalat Scandal in Italy.

<sup>786</sup> CBN Code, 2006 s.2



interest to run them well. Such arrangements should be encouraged,<sup>787</sup> but this will only be effective where the shareholders are active and corporate governance is observed because in a situation where shareholdings are used to encourage or cover up control fraud, the intentions of the Code are jeopardised. Therefore to achieve this, the Code limits government direct and indirect equity-holding in any bank to 10 per cent, while the equity-holding of above 10 per cent by an investor is subject to the CBN's prior approval.<sup>788</sup> This is intended to curb government's majority shareholding and to encourage more individual shareholdings. Perhaps it is perceived that where governments are majorly involved in banks, this may create a political control and an avenue for control frauds to occur.

As seen in the chapter on CEOs, the majority involvement of government in the banks created intimate relationships between the CEOs and other members of the board and this medium was used to defraud the companies. Structural changes are also included in the Code to restore shareholders confidence and the application of corporate governance. One of the most important provisions of the Code is that the responsibilities of the chairman of the Board of Directors should be clearly separated from that of the head of management (MD/CEO) in such a way that no one individual/related party has unbridled powers of decision-making by occupying the two positions at the same time.<sup>789</sup> The Code further stipulates that no one person should combine the post of Chairman/Chief Executive Officer of any bank. In furtherance of this provision, the Code also provides that no executive vice-chairman is recognised in the structure. In accordance with the provision of the Code, no two members of the same extended family should

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<sup>787</sup> Ibid s. 5.1.1

<sup>788</sup> Ibid s. 5.1.2-5.1.3

<sup>789</sup> Ibid s.5.2.1

occupy the position of chairman and that of CEO or Executive Director of a bank at the same time.<sup>790</sup>

Owing to the passive nature of shareholders identified by the CBN above, the SEC introduced the Shareholders' rights and responsibilities.<sup>791</sup> The SEC rules are intended to bring to the fore, the roles shareholders could play in preventing fraudulent activities in their companies and to serve as a guideline for shareholders. Although the effect of the rules can be said to be persuasive, credence is given to the provisions of CAMA and need not be repeated.<sup>792</sup>

In effect, the rules were designed to create awareness to shareholders as a sort of 'Know Your Rights' mechanism to educate them, particularly minority and passive shareholders on the roles they could play in actually curtailing the excesses of the Board of Directors. This can be achieved during the general meetings; shareholders are therefore encouraged to take the attendance of annual general meetings very seriously as one of their major responsibilities and be aware this is an avenue to effectively exercise their rights. Another key responsibility of the shareholders is in taking interest in the implementation of the Codes of corporate governance. This means that shareholders should act as watchdogs over the managers of their companies, to guard against misfortunes and to safeguard their investments.<sup>793</sup>

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<sup>790</sup> Ibid s. 5.2 of the CBN Code. For further provisions on structural changes and other changes to facilitate corporate governance and enhance shareholders' confidence, see S. 5.3-5.6 & 4.18 of the CBN Code, 2006.

<sup>791</sup> See the Securities and Exchange Commission (SEC) Shareholders Rights and Responsibilities, 2007. [www.proshare.com](http://www.proshare.com) accessed 17 June 2013

<sup>792</sup> These include voting rights, rights to attend meetings, right to ask questions and demand accountability. See generally SEC Shareholders Rights and Responsibilities Ibid. Voting should be withheld in cases where the individual or board has acted contrary to shareholders interests, or in the case of an unopposed director. (Ibid, 12)

<sup>793</sup> SEC Shareholders Rights and Responsibilities, 2007 s.11.

## 8.5 Shareholder Primacy and Corporate Performance

According to Abugu, shareholder interest is the principal means by which performance is assessed in corporate governance systems<sup>794</sup>. However, according to Blair, the notion that shareholder primacy should be based on the premise that directors and management must be accountable for shareholder value, failing which they cannot be held accountable at all is deeply flawed.<sup>795</sup> Blair sees the notion of shareholder primacy as an issue only where corporate goals are being described in the light of maximization.<sup>796</sup> However, most organizational theorists believe it may be difficult to determine what it means to ‘maximize’ business goals; therefore, economists have defined this to mean setting up challenging goals and trying to reach them.<sup>797</sup> Economists’ theory of maximization thus believes in the use of economic model of human behaviour to improve corporate performance by providing managers and directors with high-powered incentives such as stock and stock options in order for them to maximize shareholder value.<sup>798</sup>

As further explained by Blair, this conventional theory believes that unless directors and managers are closely monitored or given incentives to manage in the interest of the shareholders, they will always make decisions that will be for their own personal interest.<sup>799</sup> This form of stock-options’ based compensation creates incentives for executives (stock option holders) to win big when the stock options go up and when stock options go down, rather

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<sup>794</sup> Abugu, E.O. (2011) *Directors’ Duties and frontiers of Corporate Governance* United Kingdom: Thomson Reuters

<sup>795</sup> Blair, M. M. (2003). ‘Shareholder value, corporate governance and corporate performance: a post-Enron reassessment of the conventional Wisdom.’ *CORPORATE GOVERNANCE AND CAPITAL FLOWS IN A GLOBAL ECONOMY*, Peter K. Cornelius and Bruce Kogut, eds., Oxford: Oxford University Press. 53.84

<sup>796</sup> Monks, R., & Minow, N. (1995). *Corporate Governance* Blackwell:Cambridge, MA.

<sup>797</sup> Cyert, R. M., & March, J. G. (1963). *A behavioral theory of the firm*. New Jersey: Englewood Cliffs, NJ, 2.

<sup>798</sup> Blair (2003) Ibid p.60

<sup>799</sup> Ibid. As earlier mentioned in the Introduction, monitoring is expensive and it is difficult to monitor the monitors.

than being penalised, they are provided with even more stock options at a lower strike price which again serves as more motivation for executives to raise the stock price.<sup>800</sup> This then leads executives to take very risky decisions knowing they stand to win where the decision succeeds and in the event of its failure, they lose nothing. Rather than focusing on overall corporate performance such as accountability and financial reporting, executives tend to focus on stock price and maximizing shareholder value. This has been identified as one of the major causes of the financial crisis.

Accounting manipulation becomes a means to an end of raising the stock price and therefore enables executives to exercise their options favourably, also in the face of temptation to achieve favourable stock prices, however possible it can be. This is achieved in the form of earnings management. It is important to state that earnings management in itself is not a fraud, illegal earnings management, however is fraudulent. Earnings management is seen as a reasonable and legal management decision-making aimed at achieving stable and predictable financial results.<sup>801</sup> Illegal earnings management on the other hand involves manipulating the financial results so that they do not reflect economic reality, a system commonly known as ‘*cooking the books*’<sup>802</sup>. This is where the fraud lies. Millon also examines the concept of earnings management.<sup>803</sup> According to him, boosting stock prices should not involve earnings inflation; however, it is the thirst for consistent upward earnings that make companies understate or overstate their earnings.<sup>804</sup> Companies may therefore manipulate financial results to front performances

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<sup>800</sup> Gillan, S. L. 2001. ‘Option-Based Compensation: Panacea or Pandora’s Box?’ 14 *Journal of Applied Corporate Finance* 115–128. In the past, salary, benefits salary and performance bonuses accounted for 65 percent of CEO compensation, with stock option gains and grants amounting to 35 percent (Blair, M. M. 1994 ‘CEO Pay: Why Such a Contentious Issue?’ 12 *Brookings Review* 23–37)

<sup>801</sup> ‘What is Earnings Management?’ P.1

[http://www.swlearning.com/pdfs/chapter/0324223250\\_1.PDF](http://www.swlearning.com/pdfs/chapter/0324223250_1.PDF) accessed 20th November 2014

<sup>802</sup> Ibid

<sup>803</sup> Millon, D.K. (2002) ‘Why is Corporate Management Obsessed with Earnings Management and What Should be Done about It?’ 70 *GEO. Wash. L. Rev* 890. 897

<sup>804</sup> Ibid

that really don't exist. Many companies that go to lengths to present smooth earnings in this way get rewarded by the stock market with 'predictability premium'.<sup>805</sup>

Clearly, control fraud as a means of maximizing shareholder value using earnings management would be in the form of accounting fraud. Blair describes this as simply using the flexibility of accounting rules to smooth cash flow numbers.<sup>806</sup> An example of stock price manipulation is seen in the case of Enron whereby in the last few years leading to its collapse, the company had indeed lost track of what goods or services it provided to the public and what its core values were. Rather, what was seen was a kind of trading activity which no one could really explain, but in reality turned out to be a high profile control fraud aimed at devising a system of growing revenues for the company in order to maintain a high stock price which in turn would mean fat pay cheques for the executives. It had also manipulated its balance sheets to conceal losses and engaged in accounting fraud. It is important to state that the effect of control fraud through accounting manipulation in a bid to maximize shareholder value also extends to competitive companies who feel pressured with the need to engage in high-risk strategies in order to meet investor demands and expectations, and head off the threat of hostile takeover.<sup>807</sup>

In the United Kingdom, it has been noted that the shareholder primacy model may have ironically contributed to unfair shares.<sup>808</sup> The Bank of England's executive director for financial stability, Andrew Haldane, in a

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<sup>805</sup> Ibid (Quoting John Birger,(2000) 'Special Report: GE's Glowing Numbers, MONEY' *Nov 2000 at 312*)

<sup>806</sup> Blair (n.481) 62

<sup>807</sup> Schiesel, S. (2002)'Trying to Catch WorldCom Mirage' *New York Times* (June 30, 2002), Sect. 3, p. 1 where Executives at companies that were competing with world com reported their pressures to the press. In the words of Sprint Executive, William, T. Esrey: 'Our Performance did not quite compare and we were blaming ourselves.'

<sup>808</sup> See Andrew Haldane 'Unfair Shares' *Remarks Given by Andrew G. Haldane, Financial Stability and Member of the Financial Policy Committee* (21 May 2014) <http://www.bankofengland.co.uk/publications/Documents/speeches/2014/speech732.pdf> accessed 28 July 2014

recent speech, challenged the efficacy of focus on shareholders. Haldane's argument goes as follows:

‘Humans have problems deferring gratification. Given the choice between having something now or having a bit more later, we find it hard to wait. That goes for consumers, but it also goes for people who own and run companies. And if power resides with this particular group, what you get is widening inequality – because the fruits of a company's growth go disproportionately into raising executive pay and dividends, rather than into higher real earnings and investment. The shareholder model may, ironically, have contributed to unfair shares’<sup>809</sup>

According to him, the problem of corporate governance in firms may be twofold. While some blame it on shareholders for demanding increasing short-term returns, others blame it on management for seeking short-term financial gain in order to maximise their compensation. It therefore becomes impossible to significantly distinguish the two. Haldane goes on to draw the inference that follows in that if impatient (money-scarce) individuals fail to sufficiently invest in skills, and impatient (short-termist) companies also fail to invest in capital, the result becomes weak capital accumulation, which will subsequently lead to weak long-term investment and skills deficits.

Furthermore, in a country where shareholders are prioritised before interests of other stakeholders such as workers and suppliers are taken into consideration, the effect of power residing in one set of stakeholders who are short-termist would be high distribution of turnovers and profits rather than investing same or even distribution of same as wages. It is this inequality, that is, increase in executive and shareholder compensation at the

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<sup>809</sup> Ibid

expense of real wage growth that according to Haldane might have contributed to unfair shares.<sup>810</sup> Firms should therefore focus on all stakeholders rather than just shareholders in order to avoid the risk of future financial crisis. He goes further to call for reform of Britain's corporate governance regime aimed at providing incentives for firms that focus on long-term value for a broader range of stakeholders.<sup>811</sup>

## **8.6 Investigation of the role of Shareholders in the Banking Crisis**

The financial crisis of 2007 started in the United States in August 2007, spread to Europe by the first quarter of 2008 and became global by the fourth quarter of 2008. The global financial crisis adversely affected all sectors of the Nigerian economy, particularly the banking sector and Nigerian Capital Market.<sup>812</sup> Subsequently, there was an immediate deterioration in value of assets owned by banks, which posed liquidity issues across the affected banks.

The mandate of the Central Bank of Nigeria (CBN) is derived from the 1958 Act of Parliament, as amended in 2007.<sup>813</sup> The CBN Act of 2007 of the Federal Republic of Nigeria confers the overall control and administration of the monetary and financial sector policies of the Federal Government to the CBN. The CBN conducted special investigation on all the existing 24 banks in Nigeria in 2009. It was not surprising that the investigations of the CBN confirmed peculiar challenges in the capital base requirements of these banks, owing to fraudulent practices and bad corporate governance.<sup>814</sup> The

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<sup>810</sup> See Haldane's Speech.

<http://www.bankofengland.co.uk/publications/Documents/speeches/2014/speech732.pdf>  
p.7 accessed 1.10.14

<sup>811</sup> See Haldane *supra*

<sup>812</sup> Another major sector affected was the Oil and Gas sector.

<sup>813</sup> Central Bank of Nigeria (CBN) About CBN:

<http://www.cenbank.org/AboutCBN/> Last accessed 12.11.13

<sup>814</sup> Details of the result of the investigation have been explained in Chapter Three. However, for the purpose of illustration, relevant aspects will be utilised to explore shareholders' activities as it affects the banks in question.

CBN also injected a total of N420billion (\$2.8million) of government funds into five banks for stabilisation.<sup>815</sup>

The Nigerian banking sector underwent a consolidation through the acquisition of three banks by existing local players and a further three were nationalised by the National Deposit Insurance Company (NDIC) in 2011. The NDIC is an independent agency of the Nigerian Government that is responsible for protecting depositors and guaranteeing the settlement of insured funds when a deposit-taking financial institution can no longer repay their deposits. The NDIC established three bridge banks to take over the assets and liabilities of the three nationalised banks. The nationalisation of the three banks resulted in the creation of new banks, which were referred to as ‘bridge banks’ and the delisting of the old banks from trading on the NSE.<sup>816</sup> A breakdown of the shareholding structure of the banks shows that the former Spring Bank had 11.3 billion ordinary shares valued at 9.6billion naira, Afribank had 13.6 billion ordinary shares worth 9.49billion naira and Bank PHB had 20.2 billion ordinary shares put at 10.7billion naira.<sup>817</sup> The CBN categorised the three banks as technically insolvent as at December 2010.<sup>818</sup> Subsequently, with the establishment of Asset Management Corporation of Nigeria (AMCON) under the AMCON Act of 2010, the bridge banks were eventually sold to (AMCON) in 2011.<sup>819</sup>

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<sup>815</sup> ‘Nationalised Banks; Shareholders to sue CBN, NDIC, AMCON’ *Business and Finance* (10 August, 2011) <http://www.thenigerianvoice.com/nvnews/57904/1/nationalised-banks-shareholders-to-sue-cbn-ndic-am.html>. accessed 18 October 2013.

<sup>816</sup> NDIC Annual Report 2011 p. xiii. <http://ndic.gov.ng/publications/> accessed 12 October 2012

<sup>817</sup> ‘Nationalised banks: 32b naira worth of shares lost by Nigerian shareholders.’ [http://www.africanmanager.com/site\\_eng/detail\\_article.php?art\\_id=17147](http://www.africanmanager.com/site_eng/detail_article.php?art_id=17147) accessed 11 November 2012

<sup>818</sup> CBN Public Statement on the Recapitalisation of eight Nigerian Banks p.15 and 16 available at <http://www.cenbank.org/out/2011/pressrelease/gvd/press%20statement%20-%20gov.pdf> accessed 13 November 2013.

<sup>819</sup> CBN National Inclusion Financial Strategy, Abuja (20 January 2012) 8 <http://www.cenbank.org/Out/2012/publications/reports/dfd/CBN-Summary%20Report%20of-Financial%20Inclusion%20in%20Nigeria-final.pdf> accessed 21 January 2015



Upon the acquisition of the three bridge banks by AMCON, many critics in Nigeria did not appreciate why CBN/NDIC took that decision. The ultimate losers in the banking crisis were investors who lost a significant amount of money at the NSE on a weekly basis. In one day, investors lost N141.96billion as the total value of all the shares listed at the Exchange dropped from N7.345trillion to N7.203trillion. Furthermore, the All Share Index dropped from 22,963.11 points to 22,519.32 points, a decline of nearly 1.93 per cent. The NSE Banking index also declined by 4.22 per cent; from 317.33 points to 303.93.<sup>820</sup> This decrease was brought about by the massive decline in the share price of majority of the banks.<sup>821</sup>

The question which then comes to mind is whether or not one or more of the shareholders could have been part of the activities that led to the banking crisis and problems in the NSE. Further questions to be asked would dwell on whether there might have been a collusion of majority shareholders and the CEOs in perpetrating the fraud. Evidence published by the CBN reveals that companies and individuals owe the five banks a total of N348.409billion.<sup>822</sup>

In the investigation that follows, it will be seen that one major reason for shareholder apathy towards the activities that led to the crisis was the fact that the majority of the shareholders of the five banks were not only CEOs and Managing Directors of the banks, but also politicians, government officials and notable dignitaries. It is therefore not surprising that two presidents of the Nigerian Stock Exchange were listed by the CBN as major debtors in these banks and this includes Forbes-rated richest man in Africa,

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<sup>820</sup> Nationalised Banks: Shareholders to Sue CBN, NDIC, AMCON: <http://www.thenigerianvoice.com/nvnews/57904/1/nationalised-banks-shareholders-to-sue-cbn-ndic-am.html> (figures of 9 August 2011) accessed 18.10.14.

<sup>821</sup> There is however still a lot of controversy surrounding the decision to nationalise the previously insolvent three banks, which is mainly due to the uncompensated loss of investments for their shareholders after their sale to AMCON.

<sup>822</sup> Central Bank Advertorial: <http://www.cenbank.org/Out/publications/pressRelease/GOV/2009/ADVERTORIAL2.pdf> accessed 15 October 2013

Aliko Dangote,<sup>823</sup> who, according to the CBN, has a non-performing loan of N2.5billion with Oceanic bank which was secured through Dangote Industries Limited.<sup>824</sup>

### **8.6.1 *The politics of control fraud***

In the periods leading to the crisis, politics and majority influence had impacted on corporate governance in banks. It becomes imperative to analyse the extent to which political influence and majority shareholding of government officials in collaboration with the CEOs led to non-performing loans and accounting manipulation, that is, control fraud that gave birth to the banking crisis of 2009.

In October 2007, the EFCC published a list of five companies through which funds have been allegedly moved by the Delta State Governor, James Ibori.<sup>825</sup> These are: Notore Chemical Industries (A fertilizer manufacturing company), OandO (Ocean and Oil Company), Celtel (A Telecommunications Company), Oceanic bank and Intercontinental bank as companies. This became a serious concern for the Commonwealth Development Corporation<sup>826</sup> (CDC) because the allegations involved two of the CDC-backed private equity funds, that is, the Emerging Capital Fund (ECP) and the Ethos Fund. Both funds, which have invested in Nigerian

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<sup>823</sup> Forbes <http://www.forbes.com/profile/aliko-dangote/> accessed 6 August 2013

<sup>824</sup>Second is Mr Oba Otudeko, an immediate past president of the NSE owes N1.6billion to Oceanic bank through his company, Honeywell Group. Other top bad debtors listed by CBN include Mr. Femi Otedola, N12.8billion (Intercontinental Bank) through his company, African Petroleum Plc and another N6.2billion is owed Union Bank through his Zenon Oil; and Mr. Jimoh Ibrahim, N14.78billion (Oceanic Bank), through Global Fleet Industries Limited.

<http://www.vanguardngr.com/2009/10/cbn-releases-fresh-list-of-bank-debtors/#sthash.NMrZTvFW.dpuf> accessed 17.10.14

<sup>825</sup>‘Ibori’s Oando Deal: The Untold Story!’ *The Street Journal*, 23 September 2013 <<http://thestreetjournal.org/2013/09/iboris-oando-deal-the-untold-story/>> accessed 23 November 2013.

<sup>826</sup> Ibid. The CDC is a public limited company which is owned by the United Kingdom’s Department for International Development (DFID) which seeks to promote development in the private sector of the UK’s former colonies. As a ‘fund of funds’, the CDC provides capital to private equity funds that in turn invest in companies in the poor countries of the world.

companies, were alleged to be ‘fronts’ for money-laundering by the then governor of the oil rich Delta state. As revealed in the EFCC affidavit published by *The Street Journal*<sup>827</sup>, the allegations brought against the former governor included illegally selling off Delta State’s assets to offset a private loan from Intercontinental bank and defrauding \$290million (£196million) from Delta State. The Governor was also accused of his illegal dealings with both Intercontinental bank (where ECP had board representations) and Oceanic bank (where Ethos had board representations) were central to the charges.

The London Metropolitan Police was notified by the EFCC as the former governor was at large and had previously had criminal records in the UK. The UK courts froze his assets in the UK to the tune of \$35million and he was later arrested in May 2010, in Dubai, upon instructions by the London Metropolitan Police.

Investigations by the EFCC also revealed a series of practices whereby the corruptly obtained funds from Intercontinental and Oceanic banks were laundered within Nigeria by the governor. These include:

- selling national assets to their front-men, their associates or those close to them;
- securing private loans from banks without collateral, in return for placing government funds with those banks;
- diverting funds by moving them through a series of front companies from government accounts to personal or business accounts; and
- using front-men to carry out inflated or privileged government contracts.<sup>828</sup>

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<sup>827</sup> Ibid.

<sup>828</sup> Ibid.

Furthermore, it was revealed that the former governor allegedly used these Delta State shares in Oceanic bank as security for a loan from Intercontinental bank, after which he then sold the Oceanic bank shares illegally to repay the Intercontinental bank loan.<sup>829</sup>

Two directors of the ECP banked companies, namely, Henry Imasekha and Michael Orugbo, were also alleged by the EFCC as ‘the characters moving funds in Celtel, Notore and Oando’. Also, the Ethos-backed current Director, Obden Ibru, together with Oceanic Bank’s director, Cecilia Ibru, (mother and son) were arrested in Nigeria as associates. Obden Ibru was also listed as non-executive director of the ECP-backed Oando.<sup>830</sup> Both Intercontinental bank and Oceanic bank, where ECP and Ethos had board representation, were in distress in 2009 in which the CBN had to intervene.<sup>831</sup> ECP invested in Notore through an offshore company, Notore Mauritius. ECP’s Executive chair, Thomas Gibian, allegedly acknowledged that most of Notore’s directors in Nigeria including Henry Imasekha owned shares in Notore through Notore Mauritius. According to the EFCC, this arrangement could have been devised by the directors to avoid payment of tax on their Notore investment. Furthermore, it may have also led them to present themselves as institutional shareholders also trading as foreign investors, owing to the fact that their investment comes from an offshore company despite the fact that they are themselves Nigerians. This arrangement may also have created several layers of hidden transactions that could cause confusion on the identity of Notore’s actual owners.<sup>832</sup> For instance, the EFCC stated its concerns in 2007 of the fact that Michael Orugbo secured a loan from Oceanic bank, even though he had no previous relationship with the bank. Subsequently, following the CBN’s audit of the

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<sup>829</sup> ‘UK DFID Implicated in Widespread Corruption in Nigeria-Part 4’ *Special Reports*, 10 April, 2013 <<http://elombah.com/index.php/special-reports/15408-uk-dfid-implicated-in-widespread-corruption-in-nigeria-part-4>> accessed 2 December 2013.

<sup>830</sup> Ibori’s Oando Deal (n.825)

<sup>831</sup> Ibid. Thomas Gibian, ECP’s executive chairman had reportedly been a board member of Intercontinental bank since 2007

<sup>832</sup> Ibid.

five banks non-performing loans, Notore was listed by the CBN as Oceanic bank's biggest debtor owing a total of N32,392,951.00 (\$83,000,000).<sup>833</sup>

Furthermore, Thomas Gibian was stated by the EFCC as a non-executive director and major shareholder of Intercontinental bank, reportedly appointed in 2007. The affidavit by the EFCC indicated illegal money transfer through 'Intercontinental bank managers' cheques'. In 2009 when the CBN conducted its investigations, the CEO of Intercontinental bank (among others) was sacked, while the executive directors and senior management were required to step down. The CBN Governor ascribed the breakdown of Intercontinental bank to poor corporate governance practices, lax credit administration and absence or non-adherence to the bank's credit-risk management process.<sup>834</sup> Gibian was however not removed, as he was a 'non-executive' director, and remained so.

As regarding Oceanic bank, it was also discovered that Oceanic bank wholly owned OandO Networks, whose shares Henry Imasekha and Wale Tinubu (a family member of Bola Tinubu, the then Lagos State Governor) illegally sold to Delta State companies in 2007.<sup>835</sup> It was later revealed that these shares were potentially held in a secret and illegal arrangement on behalf of Delta state governor. It is therefore not surprising that OandO was also listed by the CBN as one of the biggest debtors of Oceanic bank, bearing in mind that Obden Ibru (Cecilia Ibru's son) is a non-executive director of both OandO and Oceanic bank.<sup>836</sup>

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<sup>833</sup> Ibid

<sup>834</sup> Sanusi Lamido Sanusi 'Address by the Governor of the Central Bank of Nigeria, Mallam Sanusi Lamido Sanusi on Developments on the Banking Sector in Nigeria (Abuja 14 August 2009) <http://www.cenbank.org/Out/speeches/2009/Govadd-14-8-09.pdf> accessed 12 October 2011

<sup>835</sup> Ibori's Oando Deal (Ibid)

<sup>836</sup> The 2008 Annual report of Oceanic bank names Obden Ibru as a non-executive bank director

It was further revealed that Oceanic bank's CEO held a total of N235billion shares, both in Oceanic bank as well as other banks and companies.<sup>837</sup> These shares were held in the name of other companies, including Dangote Sugar Refinery, Glaxo SmithKline Consumer Plc, Nestle Plc, OandO Plc, African Petroleum Plc, Dangote Flour Plc and Unilever Nigeria Plc.

Below is the list of the banks and amount of shares owned:

First Bank - 272,795,139

Access Bank - 44,800,000

Fidelity Bank - 12,500

First City Monument Bank - 7,142,800

Guarantee Trust bank - 110,000

Bank PHB - 93,800,100

UBA- 109,121

Union Bank - 13,300,000

Zenith Bank - 10.280million.<sup>838</sup>

As earlier mentioned, these shares were held in the name of companies and not in her own name. For instance, the First Bank shares are held through

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<sup>837</sup> Rescued Banks: EFCC Seizes Ibru's 103 Properties" *Proshare* <<http://www.proshareng.com/news/8814>> accessed 23 November 2013. See also "Former MD of Oceanic Bank, Cecilia Ibru, Convicted of Bank Fraud" *SaharaReporters*, 8 October 2010 <<http://saharareporters.com/news-page/former-md-oceanic-bank-cecilia-ibru-convicted-bank-fraud>> accessed 1 December 2013.

<sup>838</sup> Central Bank Advertorial: <http://www.cenbank.org/Out/publications/pressRelease/GOV/2009/ADVERTORIAL2.pdf> accessed 15 October 2013

Cloudy Heights Limited, Circular Global International Limited and Bliss Bloss Integrated Services Limited.<sup>839</sup>

Certainly, a family bank where the major shareholders are from the same family can easily falsify bank financial statements, grant non-performing loans, and divert funds for personal reasons among others. Cecilia Ibru, as the Managing Director/CEO of Oceanic bank, took advantage of the fact that the Ibru family has a majority share in the bank and her position to use depositors' money to acquire properties<sup>840</sup> all over the world and to buy shares in many companies.<sup>841</sup>

It is therefore not surprising that the subsequent resolution that Oceanic bank be acquired by Ecobank was embraced by the shareholders, the majority of whom contributed to the collapse of the bank. In an Extraordinary General Meeting held with Ecobank on 23<sup>rd</sup> December 2011, Oceanic bank approved the proposed resolution to merge both banks, transferring all assets, liabilities and undertakings of Oceanic bank, including real and intellectual property to Ecobank Nigeria.<sup>842</sup> According to the Vanguard, the shareholders were to receive N16,111,111,111 billion new shares in Ecobank Nigeria, as well as transfer of assets, liabilities and undertakings of Oceanic bank to Ecobank. The shares were to be credited as fully paid-up and Oceanic bank shareholders were to be credited with N2, 600,000,000 as deposits for shares in Ecobank, to be issued as equity at

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<sup>839</sup> Otusanya, O. J., Lauwo, S., & Ajibolade, S. O. (2013) 'An investigation of corporate executive fraud by CEOs in the Nigerian banking sector' 2(1) *African Journal of Accounting, Auditing and Finance*, 65, 78

<sup>840</sup> Ibid. Nigeria, South Africa, Dubai, London and the United States.

<sup>841</sup> Ibid. The industries in which Cecilia Ibru bought shares in include banks, oil and gas, telecommunications, aviation as well as real estates and manufacturing firms.

<sup>842</sup> 'Ecobank, Oceanic shareholders Okay Merger' *The Vanguard*, 23 December, 2011 <http://www.vanguardngr.com/2011/12/ecobank-oceanic-shareholders-okay-merger/> accessed 23 December 2013

N2.34 per Ecobank share which is to be agreed by the shareholders of both banks.<sup>843</sup>

### **8.6.2 *The case of Afribank***

While the case of Intercontinental bank and Oceanic bank can be said to be based on majority influence and political domination, which can be said to have been condoned perhaps by passive minority shareholders, Afribank reveals activism on the part of shareholders demanding for answers, although this activism was soon cut short.

In the case of Afribank, now known as Mainstreet Bank Limited, upon the initial sacking of the CEOs of the five banks in 2009, some Afribank shareholders, in a bid to request the result of the special investigation conducted by the CBN,<sup>844</sup> some Afribank shareholders had challenged the CBN's action at the Federal High Court in Lagos where the Trial Judge, Justice James Tosho, held in a ruling that the CBN did not have the absolute power to hire or fire bank directors without disclosing findings of the so-called 'special examination' conducted into the financial statements of these banks and their affected directors.<sup>845</sup> The court further held that although the CBN had power to regulate and control the business activities of these banks under Section 35 of the BOFIA, disclosure should and must be made when such powers would substantially affect interested parties as in this case.<sup>846</sup>

However, an appeal was launched by the CBN and its governor contending the decision, with a motion for stay of proceedings pending the

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<sup>843</sup> Ibid.

<sup>844</sup> Shareholders appeal Afribank's liquidation  
<http://www.vanguardngr.com/2012/07/shareholders-appeal-afribanks-liquidation/> accessed 15 October 2013

<sup>845</sup> CBN is frustrating our case- Afribank Shareholders  
<http://www.vanguardngr.com/2011/12/cbn-frustrating-our-case-afribank-shareholders>  
accessed 17th October 2013

<sup>846</sup> Ibid.



determination of the appeal. However, while the matter was still pending in the appeal court, the CBN, in collaboration with the Nigerian Deposits Insurance Commission (NDIC) and the Asset Management Corporation of Nigeria (AMCON) nationalised Afribank.<sup>847</sup> The shareholders then filed a motion to nullify the nationalisation, claiming that it was done pending an appeal and also in disrespect to the court and that the CBN had filed the motion for stay of proceedings in order to frustrate the diligent prosecution of the case.

The above scenario was further compounded when the CBN filed another suit at the Federal High Court in Lagos, winding up the bank. Justice Charles Archibong, in his decision, wound up Afribank on the ground that the bank had been delisted by the CBN and therefore had no licence to continue to operate.<sup>848</sup> Further efforts of the shareholders to challenge the CBN proved abortive.<sup>849</sup>

From the above, it can be said that the shareholders of Afribank were ignorant of the insider abuse and control fraud in the bank and the revelations of the CBN triggered their demand for questions. However, these attempts of shareholders to demand for answers have been frustrated and while it can be rightly said that the CBN acted *ultra vires* its powers in sacking the CEOs without publishing the results of its special investigations, and subsequently winding up the bank. The shareholders argued through their counsel, Mr Onyebuchi Aniakor, that the winding up order was made by Justice Archibong when the matter was stated for mention and not hearing.<sup>850</sup> Furthermore, upon the winding up petition brought by the CBN, the shareholders had made a preliminary objection to the petition, claiming that there was a pending suit before Justice Tosho of the same court and also

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<sup>847</sup> The nationalisation of Afribank was done with two other banks: BankPHB and Spring Bank which saw the birth of Mainstreet Bank, a newly formed bank.

<sup>848</sup> *Vanguard news*, 16 July 2012 <http://www.vanguardngr.com/2012/07/shareholders-appeal-afribanks-liquidation/> last accessed 19.10.13

<sup>849</sup> This case is further discussed in the next chapter.

<sup>850</sup> *Vanguard News*, 16 July 2012 Ibid

arguing that the winding up petition is a calculated effort by the CBN to overreach the pending suit. What is surprising is that this preliminary objection was struck out by the court. A number of issues would arise, questioning the independence of the judiciary and the power and manipulation exhibited by the CBN. However it is to be noted that these issues would be analysed in detail in subsequent chapters as this chapter only focuses on shareholders.

It suffices to say that the case of AfriBank contrasts with that of Oceanic Bank where the majority of the shareholders were involved in control fraud, hence the prompt decision to merge the bank. The case of AfriBank suggests that minority shareholders' rights were not strong enough to create a dominant voice. Whether or not increasing the strength of minority shareholders will indeed prevent or reduce control fraud in Nigeria may not be known for certain, but it is important to say that since the banking crisis, positive attempts have been made to strengthen shareholders' rights and responsibilities in Nigeria and this is elaborated below.

### ***8.6.3 Control fraud through rent seeking***

As revealed above, one major inhibition to effective corporate governance practice that led to the collapse of the 2009 bank in Nigeria include the fact that politicians were involved as shareholders and directors of some of the banks, such as the Delta State Governor, mentioned above. It can therefore be said that political connections were used to obtain public-sector deposits. This is known as rent seeking. According to Krueger, rent seeking occurs in market-oriented economies with government restrictions in economic activities, whereby people compete for rents.<sup>851</sup>

Krueger examines situation where rent seeking can be seen as competitive;

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<sup>851</sup> Krueger, A. O. (1974). The political economy of the rent-seeking society. *The American economic review*, 291-303.

that is, in case of quantitative restrictions on international trade. According to him, although rent seeking may be seen as a legal and healthy competition, the problem arises when it is achieved through bribery, smuggling and corruption.<sup>852</sup> As seen above, majority of the shareholders were from the public sector such as ministries and government bodies, most of the banks therefore rely on government for deposits, licenses and other favours and by so doing, they become indebted to the government.<sup>853</sup> Due to political pressure, the banks may be forced to make illegal decisions that will generate future deposits from the majority shareholders. These include control fraud through collaborative embezzlement where government officials uses the bank to defraud the government transferring key accounts to specific banks with which they have worked out a profitable arrangement (as seen above).<sup>854</sup>

A notable example is the case of Oceanic bank, where it was discovered that the bank (through its CEO) wholly owned a number of companies including OandO Networks and the CEO's son, Obden Ibru was a non-executive director of both Oceanic bank and OandO, Subsequently, OandO illegally sold shares to a number of Delta State based companies in 2007.<sup>855</sup> It was later revealed that these shares were potentially held in a secret and illegal arrangement on behalf of Delta state governor. It is therefore not surprising that OandO was also listed by the CBN as one of the biggest debtors of Oceanic bank, bearing in mind that Obden Ibru (Cecilia Ibru's son) is a non-executive director of both OandO and Oceanic bank.<sup>856</sup> This is a good

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<sup>852</sup> Krueger, Ibid

<sup>853</sup> Yauri, N.M. (2012) 'Bank Recapitalisation in Nigeria: Resuscitating Liquidity or Forestalling Distress?' 3(10) *International journal of Business and Social Science*, 230 <[http://www.ijbssnet.com/journals/Vol\\_3\\_No\\_10\\_Special\\_Issue\\_May\\_2012/31.pdf](http://www.ijbssnet.com/journals/Vol_3_No_10_Special_Issue_May_2012/31.pdf)> accessed 22 November 2013.

<sup>854</sup> UK High Court Orders Rogue Banker, Erastus Akingbola, to Surrender £68 Million Loot to Intercontinental Bank' *Sahara Reporters*, 4 April 2011 <<http://saharareporters.com/news-page/uk-high-court-orders-rogue-banker-erastus-akingbola-surrender-%C2%A368-million-loot-intercontin>> accessed 6 December 2013.

<sup>855</sup> Ibori's Oando Deal (Ibid)

<sup>856</sup> The 2008 Annual report of Oceanic bank names Obden Ibru as a non-executive bank director

illustration of control fraud due to rent seeking, particularly where majority shareholders are very influential public sector personalities. This collaborative form of control fraud is usually shielded from minority shareholders and the general public during general meetings.

### **8.7 Shareholder Activism in Nigeria**

Corporate governance embodies the totality of systems by which companies are directed and controlled<sup>857</sup> and this involves promoting fairness, accountability and transparency within the organisation, the frictions that arise due to this are sometimes expressed through shareholder activism.

Adebite et al. consider the extent to which a country's local shareholder activism is a reflection of its brand of politics.<sup>858</sup> They describe shareholder activism as a corporate governance accountability mechanism, whether at the managerial or board level.<sup>859</sup> Shareholder activism consists of a variety of activities through which shareholders influence the management and board. This can be in the form of meetings, letter writing or associations as the case may be.<sup>860</sup> Gillian and Starks consider a shareholder activist as an investor who, through his voice, endeavours to change situations of concern, while not necessarily resulting to change in the firm's control.<sup>861</sup>

There is no gainsaying that shareholder activism is jurisdiction-based and rationales for shareholder activism differ according to countries. However, contrary to the general view that shareholder activism is driven by the desire

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<sup>857</sup> Cadbury Report, 1990 s. 2.5. Available at <http://www.ecgi.org/codes/documents/cadbury.pdf> accessed 21 December, 2014

<sup>858</sup> Adebite, E. Amaeshi, K., Amapo, O. (2012) 'The Politics of Shareholder Activism in Nigeria' 105 *Journal of Business and Ethics* 389-402

<sup>859</sup> Ibid 391

<sup>860</sup> Becht, M., Franks, J., Mayer, C., & Rossi, S. (2010). 'Returns to Shareholder Activism: Evidence from a clinical study of the Hermes UK Focus Fund.' 22(8) *The Review of Financial Studies*, 3093-3129

<sup>861</sup> Gillian, S.L., and Starks, L. T. (1998) 'A survey of Shareholder Activism: Motivation and empirical evidence.' 12(3) *Journal of Corporate Finance* 275-305

to maximize shareholders' wealth, there is evidence to suggest that the need for responsible ownership is a driving force to shareholder activism.<sup>862</sup>

Following the banking crisis in Nigeria, coupled with the activities of the CBN, CEOs and the threat of collapse of the Nigerian Stock Exchange, shareholders have been awakened to their rights and responsibilities. A number of shareholder associations have been developed by shareholders as avenues for exercising their rights as a group. These include Proactive Shareholder Association, the Nigerian Shareholders' Solidarity Association and the Independent Shareholders' Association of Nigeria. This is seen as a positive step towards shareholder involvement in companies.

One case of shareholder activism saw the President of the Progressive Shareholders Association, Mr. Boniface Okezie, suing the CBN<sup>863</sup> to declare the cost to the Central Bank of Nigeria (CBN) and the Government and people of Nigeria so far of the banking reforms instituted by the CBN, and particularly, the total cash and value of properties recovered from Oceanic bank's former CEO, the whereabouts of the money and properties, and what part of this cash and properties has been returned to Oceanic bank and/or its shareholders. Honourable Justice M.B. Idris ruled that the CBN should provide information within 72 hours of the total cash and value of properties recovered from Oceanic bank's CEO, the whereabouts of the money and properties, and what part of this cash and properties has been returned to Oceanic bank and/or its shareholders.<sup>864</sup> The action taken by the President of the shareholder association shows that shareholder activism is

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<sup>862</sup> See Hendry, J., Sanderson, P., Barker, R., and Roberts, J. (2007) 'Responsible Ownership, Shareholder value and the new Shareholder activism.' 11(3) *Competition and Change*, 223-240, Sarkar, J., and Sarkar, S. (2000). 'Large shareholder activism in corporate governance in developing countries, Evidence from India.' 1(3) *International Review of Finance*, 161-194

<sup>863</sup> For instance, the case of *Mr. Boniface Okezie v The Central Bank of Nigeria* Suit No. FHC/L/CS/494/2012  
<[http://www.r2knigeria.org/index.php/absu-gang-rape/doc\\_download/90-boniface-ekezie-vs-cbn](http://www.r2knigeria.org/index.php/absu-gang-rape/doc_download/90-boniface-ekezie-vs-cbn)> accessed 4 December 2013.

<sup>864</sup> *Boniface Okezie v The Central Bank of Nigeria* Ibid

really thriving in Nigeria. Following the banking crisis, corporate governance regulations now make provisions for shareholders involvement in banks.<sup>865</sup>

Having said that, mention must also be made that shareholder activism in Nigeria has been influenced by the political culture of the country. The problem of corruption has been a problem since inception and has remained endemic even in the corporate sector. Adegbite et al, in their survey of the politics of shareholder activism in Nigeria, also considered the link between politics and pursuit of corporate interests and found that companies bidding for government contracts are forced to play by the rule of politicians.<sup>866</sup> The success of any business is therefore dependent upon its level of political will and support. Adegbite et al also suggested that even though shareholders can propose resolutions at meetings, due to the level of corruption in society, leaders of shareholder associations are prone to bribes in order to inappropriately support management. A lack of information, shareholder apathy and a weak judicial system for shareholders to seek redress are other reasons attributed by Adegbite et al.<sup>867</sup>

Going back to the case of Afribank's shareholders, the level of political and power influence utilised to frustrate shareholder activism is shocking. While shareholders are constantly demanding accountability and transparency of directors, management and regulatory bodies, their activities are constantly undermined even at the judiciary level where justice is meant to be done.

That notwithstanding, there is also a fundamental problem of misconception and misuse of shareholder activism by members to the extent that they are gradually being conceived as a threat to the organisations' day-to-day

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<sup>865</sup> A number of Codes published after the crisis now makes provision for shareholders. See generally the CBN Code 2014 and SEC Code 2011 (Discussed in Chapter 5)

<sup>866</sup> Adegbite *et al* (n.858) 396

<sup>867</sup> *Ibid*

management.<sup>868</sup> This is based on the manner by which shareholder associations tend to comport themselves in the exercise of their rights, such as bullying and boycotting of AGMs. Commenting on this, Adegbite et al noted that some members of shareholder associations have expressed their concern on the way some of their members conduct themselves through negative publicity arising from threats and disruptions of meetings.<sup>869</sup> Perhaps this action is triggered out of frustration and as a means of a cry for help, but to whom?

## 8.8 Summary and Conclusion

This chapter examined Nigeria's shareholding structure and investigates the activities of shareholders in the banking crisis. It can be said that although adequate legal provisions exist in the CAMA and SEC Code for Shareholders as to educate shareholders of their rights and responsibilities, it was not until the crisis that shareholders actually became aware of these rights. They can therefore be said to have been more concerned with the financial turnovers of the company as opposed to activities of the board, thus, providing a perfect environment for control fraud.

While it can be said that large shareholders will be more likely to make use of their voting power to influence managerial behaviour in their favour, through their voting rights and subsequently create an avenue to perpetrate fraud,<sup>870</sup> it can also be said on the other hand, that there is a proposition that large shareholders will exercise more effective corporate governance, by way of monitoring the activities of the management and it has found support from a host of studies on developed market economies. This is exemplified

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<sup>868</sup> Ibid

<sup>869</sup> Ibid

<sup>870</sup> Babatunde, M. A., Olaniran, O. (2009). 'The effects of internal and external mechanism on governance and performance of corporate firms in Nigeria.' 7(2) *Corporate ownership & control*, 330-343. <<http://www.virtusinterpress.org/IMG/pdf/Paper19.pdf>> accessed 22 November 2013, (citing A. Shleifer & R.W. Vishny, "A Survey of Corporate Governance" NBER Working Paper No. W5554, 1996. )

by a study of German Private Enterprises, which discovered that concentrated share ownership is associated with high rates of turnover of directors.<sup>871</sup>

Vishny et al. are of the view that high concentration could reduce agency costs since it could serve as a substitute for legal protection. Even in the absence of strong legal institutions, large investors have the means and the incentives to monitor managers, though they bear the cost of undiversified risk. However, the problem here is that large shareholders may use their control rights to circumvent minority interests;<sup>872</sup> and this is the case in Nigeria where large shareholders would rather use their vantage position to enrich themselves by engaging in sharp practices such as insider trading, issuance of non-performing loans, money-laundering and other illicit banking activities.

Although there is no consensus yet as to how ownership concentration impacts on performance,<sup>873</sup> Holderness and Sheehan, on their part, discovered little evidence showing that high ownership concentration directly affects performance of a company.<sup>874</sup> However, as shown in Oceanic bank, where family ownership led to laxity on the part of the shareholders, majority shareholders' actions negatively affected the performance of these banks.

Furthermore, in Nigeria, where directors, who are also shareholders, are charged with the responsibility of managing a bank, the potential of incessant squabbles and political patronage at the detriment of the banks

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<sup>871</sup> J. Franks, C. Mayer, (1996) 'Hostile Takeovers and the Correction of Managerial Failure' 40(1) *Journal of Financial Economics*, 163–181

<sup>872</sup> La Porta, R., Lopez-de-Silanes, F., Shleifer, A., & Vishny, R. (1999). 'The quality of government' 15(1) *Journal of Law, Economics, and organization*, 222-279.

<sup>873</sup> Babatunde, M.A & O. Olaniran, O (n. 870).

<sup>874</sup> Ibid (referring to Holderness, C. G., and Sheehan, D. P. (1988). 'The role of majority shareholders in publicly held corporations: An exploratory analysis.' 20 *Journal of financial economics*, 317-346.)



tend to rise, thus paving the way for frauds to be perpetrated.<sup>875</sup>

In Nigeria, it can be said that concentrated shareholdings contributed to the banking crisis. It is therefore suggested that shareholdings should be dispersed rather than concentrated. This is due to underlying problems in the country such as political influence and corruption. Majority shareholdings will pave the way for fraud in a country where corruption is endemic. It is therefore hoped that the Code of Corporate Governance aimed at prohibiting majority shareholdings over 10%, as discussed above, may help solve the problem of government concentration, but what about individual concentration, especially where majority shares are held in the name of family members or even companies that cannot easily be linked to one person? It suffices to say that the problem of concentrated shareholdings in Nigeria may not easily be solved by merely changing the rules, but by making sure background checks are made for potential shareholders.

Despite the legal rules in place emphasising shareholders' voting rights and also prohibiting management agenda control, shareholder activism in Nigeria is still emerging and it can be said that under a more facilitating regulatory and judicial environment, associations might do much more. In 2007, shortly before the crisis, SEC published a Code of Conduct for Shareholders Associations to 'ensure the highest standard of conduct amongst association members and the companies with whom they interact as bona fide shareholders'.<sup>876</sup> The code was designed to ensure that association members uphold high ethical standards and make positive contributions in ensuring that the affairs of public companies are run in an

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<sup>875</sup> Adeyemi, B. (2011) 'Bank Failure in Nigeria: A Consequence of Capital Inadequacy, Lack of Transparency and Non-Performing Loans?' 6(1) *Banks and Bank Systems*, 107 <[http://businessperspectives.org/journals\\_free/bbs/2011/BBS\\_en\\_2011\\_01\\_Adeyemi.pdf](http://businessperspectives.org/journals_free/bbs/2011/BBS_en_2011_01_Adeyemi.pdf)> accessed 21 November 2013. It is important to reiterate that efforts to collect data and evidence of the percentage of shares owned by majority shareholders in the banks proved abortive.

<sup>876</sup> SEC Code of Conduct for Shareholders Associations, 2007 [http://sec.gov.ng/code\\_of\\_conduct\\_for\\_shareholders\\_associations.html](http://sec.gov.ng/code_of_conduct_for_shareholders_associations.html) accessed 15 November 2013

ethical and transparent manner and also in compliance with the Code of Corporate Governance for public companies.<sup>877</sup> The Code encouraged shareholders to attend meetings regularly either in person or through their proxy and should maintain decorum during meetings.<sup>878</sup>

The Code particularly stresses that Shareholder associations should promote good governance of their companies. They should also help to influence corporate governance policies that encourage investment and promote the interest of shareholders and shareholder value.<sup>879</sup> Clearly the Code was not enough to prevent the 2009 banking crisis. Shareholder education and involvement in banks remained minimal up until the banking crisis. Again, as stressed in earlier chapters, the problem cannot be said to be lack of adequate regulation, but enforcement and compliance to existing regulations. While shareholders are being provided with the rules, little or nothing was done to actually educate them on the existence of these rules and here lies the problem.

Furthermore, a number of shareholder associations have developed a list of problems encountered by shareholders, which can be said to be contributory factors to the crisis experienced in the corporate economy.

Their findings were published by the House of Representatives Report of the Ad hoc committee on the investigation into the near collapse of the Nigerian Capital Market, most of which are highlighted below:<sup>880</sup>

- Manipulation of the market using delisted companies
- Regulatory failure of the financial sector regulators
- Sensitive banking reforms

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<sup>877</sup> Ibid

<sup>878</sup> Ibid s.2 (a)(c)

<sup>879</sup> Ibid s. 2(d)

<sup>880</sup> See Report of the Ad-Hoc Committee on Capital Market on the near collapse of the Nigerian Stock Exchange, p. 11-14

<http://proshareng.com/news/download.php?item=AdHocCommitteeonCapMktReport19%20200712.pdf> accessed 17 December 2014

- Investors' ignorance
- Lack of co-ordinated relationship between shareholders and the SEC
- Corporate failure in the institutional and governance structure of the Securities and Exchange Commission
- The Nationalisation of Shareholders Investments in Afribank, Bank PHB and Spring Bank.
- Overriding influence of the CBN Governor on the financial sector. (The Governor is the de facto head of SEC, NSE and the Chief Executive Officer of the banks)
- Enforcement failure

The Committee, while evaluating the issues listed above highlighted by the associations, noted that:

‘The uninformed investors provided a vacuum pump that the operators and regulators used to effect a sustained share price manipulation. On the part of the financial system, it appears that there were only two attributes of emergent regulatory environment: corruption or incompetence either is bad for the financial system... The associations believe that as things go wrong in the financial system, the government remained a mere observer’<sup>881</sup>

The above quote from the House of Representatives suggests that shareholder associations believe that their ignorance and incompetence opened the way for corruption and fraud, and the government merely watched. It is therefore important that shareholders are actively aware of their rights and responsibilities and take steps towards preventing an avenue for perpetration of fraud. This can be in the form of attending meetings and

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<sup>881</sup> Ibid 13

asking questions where necessary. Shareholders should not only be concerned with dividends and profits. The need for shareholder associations therefore becomes important to help promote healthy activism within the country.

Although, it can be said that effective shareholder activism could promote corporate governance, while shareholder activism tends to be emerging and should be encouraged, concentrated shareholdings, coupled with the level of corruption and power influence exhibited during the banking crisis, suggests a more institutionalised problem in the country.

## **Chapter 9**

### **Can Corporate Governance Regulations Help Prevent Control Fraud in Nigerian Banks? The Way Forward**

#### **9.1 Introduction**

This thesis aimed at investigating control fraud in Nigerian banks using the 2009 banking crisis as a case study. The thesis linked corporate governance regulations pre and post- banking crisis to the role of various actors and sought to examine whether or not there existed adequate legal and policy regulations that could have prevented the fraud. The chapter on corporate governance regulations indicated a number of problems such as duplication and inconsistency; This would then suggest that prevention of control fraud is not in itself determined by the provision of adequate corporate regulation but also requires other structures and the contribution of a range of stakeholders and other actors which together should help to prevent future control frauds in Nigeria.

Having established that, it is the focus of this chapter to propose recommendations that can help prevent future control frauds in Nigerian banks. In doing this, the chapter will recap the major issues explored in the course of this thesis for the purpose of suggesting recommendations. The chapter starts from the premise that fraud is endemic, especially in a country like Nigeria, and that it is therefore impossible to completely eradicate fraud in Nigerian banks. What can be seen, however, is that a substantial reduction in control fraud could be achieved if various bodies are reformed so that they are more likely to contribute to this goal; therefore, because corporate actors are important factors in control fraud, any attempt to prevent or reduce control fraud in Nigerian banks should include an attempt to examine the role of stakeholders and other corporate actors in the prevention of control frauds. Furthermore, the chapter also discusses

contributions to theory, policy and practice in the light of the recommendations proposed.

The thesis concludes that eradicating control fraud requires teamwork, and that each actor in corporate governance should contribute to this, with no single body saddled with the sole responsibility of ensuring good corporate governance. It is very important that the system should be coherent. Furthermore, the peculiarity of jurisdictions will mean that some aspects of corporate governance regulation in any economy should be culture-specific. In the case of Nigeria, this implies a number of things, including the need to eradicate or reduce corruption, educate major corporate actors and most importantly, improve enforcement mechanisms.

In order to propose recommendations, it is important to reiterate the two major challenges of corporate governance and control fraud that have been identified throughout the course of this research; these are institutional corruption and the problem of enforcement. The sections that follow recap these two challenges and set out recommendations for reform.

## **9.2 Corporate Governance Regulation in Nigeria: A problem of Enforcement?**

It is important to reiterate that the issue of enforcement is one of great concern, especially in a developing country like Nigeria. The nature of the country's corporate environment, which has been polluted with corruption and political influence, remains a hindrance to good corporate governance and economic development in the country, and has also opened the way for control fraud in Nigerian banks. The main objective of this thesis was to investigate Nigeria's corporate governance regulation in the wake of the 2009 banking crisis and to assess whether or not regulation can help prevent future control frauds in Nigerian banks. The preceding chapters began with an expository of the nature of control fraud in Nigeria, followed by the role

of active participants in control fraud. Enforcement as a problem was mentioned throughout the course of this research. It is an endemic regulatory problem in Nigeria which mere legal provisions cannot seem to solve. It is worth recapping the provisions relating to enforcement, compliance and sanctions for the purposes of this section. The issue of provision of sanctions and compliance will only arise in a mandatory code. A voluntary code will be merely persuasive in encouraging companies to adopt and practice its principles but will impose no sanctions for non-compliance. Needless to say, the SEC code has no compliance procedures in place.

The 2006 CBN code merely provides that compliance is mandatory but fails to provide how compliance shall be monitored. The code provides in Section 6.1.4 that false rendition of accounts to the CBN shall attract a stiff sanction of fine plus suspension of the CEO for six months in the first instance, and removal and blacklisting in the second, whilst the defaulting staff would be referred to a professional body for investigation.<sup>882</sup> These compliance provisions seem quite weak to the extent that the CBN has not put in place any system for monitoring rendition to the CBN. As discussed in the previous chapter on CBN, using fines to ensure compliance is inadequate in a country with institutional corruption because control fraudsters will be quick to bypass regulatory measures, knowing they can always get away with a fine.

Furthermore, the problem of regulatory enforcement in the periods before the crisis saw a wave of control frauds that were swept under the carpet. Lack of adequate regulatory enforcement paved the way for the massive control frauds of 2009. A number of enforcement failures discussed in this research are recapped below:

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<sup>882</sup> CBN Code, 2006 s.6.1.4

First is the judiciary. It is important to also note the problem associated with the judiciary and how Nigeria's political environment has been used to influence the CBN's intervention during the crisis. Although legal action was jointly taken by the CBN and the EFCC, to date, only one of the five cases has been decided in Nigeria. The rest of the executives have fled the country or escaped trial on medical grounds.

As seen in the chapter on the CBN, the only trial that has been concluded in Nigeria is that of Mrs Cecilia Ibru who entered into a plea bargain where she pleaded guilty in order to have her sentences run simultaneously. In this regard, she was sentenced to 6 months in prison for three counts and she only had to serve one term of six months. This does not seem adequate compared to the crimes she had committed. Perhaps the leniency of her punishment may be due to her political connections.

That notwithstanding, other cases remain pending. Perhaps some have been swept under the carpet. The slow and time-consuming pace of the judiciary can be seen as a deliberate measure either by the CEOs themselves or even the judiciary, as an act of corruption.

It is important to reiterate the statement of Sanusi when he talked about the problem of vested interests in Nigeria:

'For the second CEO, we finished our case, established in Nigeria – we had a civil case in the UK, we had a criminal case in Nigeria – established the case... two weeks before the closing statements were made the judge was miraculously promoted to the Federal Court of Appeal. After three years of trial at the very end of trial!

Because someone, a very popular religious leader with hundreds of thousands of supporters, carried into political authorities, and the system that was supposed to protect



depositors and handle criminals was used and manipulated to promote a judge so that he would not convict a thief'.<sup>883</sup>

This reveals a fundamental judicial problem in the country. It is important that the judiciary is independent and conducts itself in a free and fair manner. The judiciary has been politically manoeuvred for the benefits of the CEOs who use their affiliations to elude themselves from being convicted.

Furthermore, the cases of Afribank and Union Bank discussed in the previous chapter also revealed the judicial manipulation that exists in the country. As examined in the case of Afribank, there was duality of proceedings brought to court at the same time; yet all efforts by shareholders notifying the court of this duality proved abortive. The judiciary was seen to have disregarded all the cries of the shareholders and ultimately carried out a miscarriage of justice when it struck out preliminary objections brought by the shareholders. Issues regarding judicial independence cannot be ruled out in Nigeria as power and manipulation become more evident on a daily basis.

Another enforcement failure lies in the regulatory power of the CBN. Although this has been dealt with in chapter six, it is however important to stress that the lack of co-ordination among the CBN and other regulatory agencies such as the SEC is an issue that calls for urgent attention if future control fraud is to be prevented. As a regulator, the CBN could have done more to prevent the crisis. Certainly apart from its own internal

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<sup>883</sup> Sanusi Lamido explodes: How vested interests are killing Nigeria. <http://www.premiumtimesng.com/news/153212-sanusi-lamido-explodes-how-vested-interests-are-killing-nigeria.html> accessed 22 December 2014

disorganisation within the CBN, it also granted most of these banks use of the Discount window over and over again.

While it can be said that the CBN might have indeed been a victim of the fraud as bad loans were fronted to the CBN in order to obtain money, however, as a regulator the CBN ought to have suspected banks that were excessively using this discount window. Adequate procedures ought to have been in place that would have flagged up banks that kept coming back to the CBN for financial assistance because this raised a suspicion of insolvency rather than illiquidity. A well-regulated system would take time to look at the books even after the financial assistance has been provided so that it could satisfy itself of the legality and quality of the loans owed to the bank. Regular inability of borrowers to repay these loans should have meant that the bank had to be specially investigated.

Furthermore, the enactment of a new code, that is the 2014 CBN Code, took five years after the crisis. But is this new Code the solution? As noted in chapter five on corporate governance regulation, regulatory multiplicity itself creates ambiguity and an opportunity for even more control fraud. It might be suggested that it would have been better to reinforce the previous code in terms of enforcement rather than introduce a new comprehensive code which on the face of it may look promising but it may only be a matter of time until the country witnesses another set of control fraud. It therefore suffices to say that what is needed is a set of enforcement mechanisms for the existing codes. The enforcement strategies should first take into account the peculiarity of Nigeria as a country with institutional challenges and then consider banks as a specific type of entity with unique corporate governance mechanisms in order to proffer solutions that can help prevent future control frauds in Nigerian banks.

### 9.3 Control Fraud: An Institutional Problem of Corruption

As noted by Adegbite, corruption has traditionally been at the centre of corporate governance regulation in Nigeria (and Nigerian banks) and became a way of life since the country's independence from Britain.<sup>884</sup>

It is important to mention that although Nigeria's corporate sector is regulated through a combination of the Companies and Allied Matters Act (CAMA) and Corporate Governance Codes, the Securities and Exchange Commission (SEC) stresses that effective corporate governance rests ultimately with the CEO and board of directors and there is need to improve board competence and integrity, especially in their relationship with other actors such as the shareholders and audit committee.<sup>885</sup> SEC further adds that the problem of fraud in Nigerian Plc's can be linked to a series of underlying problems such as opaque regulations, weak enforcement mechanisms and lack of checks and balances indicating that Nigeria's corporate governance is still at a rudimentary stage with only about 40% of public limited companies following Corporate Governance Regulations.<sup>886</sup>

As we have seen, the banking sector is not immune from this high level of corruption. This research investigated the high profile cases of CEOs of five banks who were able to behave in a corrupt manner in their banks for a number of years. It should be stressed that control fraud is an opportunistic type of fraud which uses ongoing deficiencies to manipulate situations. As predators, they 'spot and attack' human regulatory weaknesses to their advantage. They cause the firm to invest in transactions that are adequate for perpetration of fraud. These are transactions with readily unascertainable market values and utilise professionals as superior vehicles, flaunting

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<sup>884</sup> Adegbite, E. (2012) 'Corporate Governance in Nigeria: Towards Governmental Engagement' 7(3) *Int. Journal of Business Governance and Ethics*.209-231 at p.214

<sup>885</sup> See the preamble to the SEC draft Code of Corporate Governance, 2008.

<sup>886</sup> Ibid

themselves as legitimate leaders, while moving the company to the best level suitable for weak regulation and accounting fraud. According to Black:

‘Audacious control frauds transform the environment to aid their frauds. The keys are to protect and even expand the range of accounting abuses to weaken regulation. Only a control fraud can use the full resources of the company to change the environment... control frauds use the company’s resources to buy, bully, bamboozle, or bury the regulators.’<sup>887</sup>

Skilful concealment is also utilised to perpetrate the fraud and it commonly involves manipulation of ‘cut off’ procedures, which are laid down as a means of checks and balances to ensure correlation between purchase records and stocks following the end of an accounting period.<sup>888</sup> In effect, the aim is to ‘bolster’ or ‘shore-up’ a company in an unsecure financial and managerial position as a tool for maintaining confidence of shareholders, creditors and investors.<sup>889</sup> In a corrupt environment, financial manipulation becomes almost normal.

Furthermore, according to Yakasai:

‘The complexity and trouble with most banks in Nigeria is that the directors work to the answer, mark their own examination scripts, score themselves distinctions and initiate the applause. But to the stakeholders (especially

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<sup>887</sup> Black, W. K.. (2005) *The Best Way to Rob a Bank is to Own One* Texas: University of Texas Press p.3

<sup>888</sup> Iwu-Egwuonwu R., C. (2011) ‘Behavioural Governance and Corporate Governance quality’ 3(1) *Journal of Economics and International finance*, 7. See also the popular English case of *Re Thomas Gerard and Sons Limited* (1986) CH. 455 which is quite an interesting example of fraudulent manipulation of accounts whereby the managing director of a limited liability company adopted the use of cut off procedures leading the company to pay dividends in error out of capital to the amount of £26,254 and also pay £56,659 in excess of its liability.

<sup>889</sup> Black (n.738)

the equity owners), the excellent report sheets are openly fudged or at best engineered and indeed the activities of the board are so varied and deceptively intractable that the more critically you look, the less you see.<sup>890</sup>

The institutional nature of corruption is endemic in the country. From day-to-day activities to big financial transactions, every sector of the economy has been badly polluted with corrupt practices and the banking sector is not left out. Right from independence, Nigeria suffered from bad political administration where government officials converted the country's wealth to their own pockets. The country witnessed a series of military rule before 1999 when democracy was introduced. The period between 1999 to date, which is meant to be a civilian/democratic government, has seen even more political and economic corruption and one wonders whether Nigeria is actually benefiting from democracy.

#### **9.4 Nigeria: A Country of Vested Interests?**

The years that followed the banking crisis saw a number of issues unfold in the country. It is important to note that the two major sectors affected by the crisis are the banking and oil and gas sector. While this thesis focuses on the banking sector, it is necessary to mention that the CBN governor also carried out investigations on the oil and gas sector and revealed a series of corrupt practices that were and are still prevalent in the country. Attempts to bring the fraudsters to book saw the removal of the CBN governor who was first suspended in February 2014 and subsequently sacked.

Why then did the CBN Governor get sacked? A number of questions arose following the activities of the president. The Governor challenged his suspension at the time but obviously, this did not stop him from getting

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<sup>890</sup> Yakasai, A. (2001). 'Corporate Governance in Third World Countries With Particular Reference to Nigeria' 9(3) *Corporate Governance, An International Review* 239-250 at p. 240-241

sacked. Perhaps the revelations of the CBN Governor led to his being removed from office.

Although a lot of concerns have been raised on the underlying problems of the CBN and the reasons why the CBN might have failed as a regulatory body, thereby paving the way for control fraud, it is important to say that it is impossible for one single person to reform a system. Perhaps that is the problem faced by Sanusi. Shortly before his suspension, he had delivered a speech where he talked about overcoming the fear of vested interests and examined how vested interests are killing Nigeria.<sup>891</sup>

According to him:

‘We must recognize that at the heart of the problem of Nigeria, at the heart of ninety per cent of our issues – from Boko Haram, to religious crisis, to ethnic crisis to unemployment, to the lack of education, to the lack of health care – is that there are people who profit from the poverty and underdevelopment of this country. And these people are called Vested Interests’.<sup>892</sup>

Sanusi shared his experience in the banking and oil and gas industry. Some of his findings have been explained in this chapter and previous chapters. Particularly, he talked about how the banking industry was polluted by the time he assumed office. He mentioned the level of corruption in the banking industry. According to him, the CEOs in 2009 had become untouchable, having both political and economic powers. They therefore believed no one could touch them, and people (including the CBN) were scared of challenging them in fear of getting sacked.<sup>893</sup>

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<sup>891</sup> Ibid

<sup>892</sup> Ibid

<sup>893</sup> Ibid

These are the people who he calls ‘Vested Interests’. They were simply defrauding money from their banks and using it to purchase properties across the world. Sanusi further stated that the banks that they saved during the crisis had a total of about eight million customers with about N4.4trillion (\$2.4billion) in deposits.<sup>894</sup> According to him, the eight million people consist of dedicated old people who had saved their money for 40-50 years only to find out one day that their money was gone. He also referred to civil servants who had worked for 35-40 years to save money for their pension, medical bills, school fees of their children and then woke up to realise that the bank has failed.<sup>895</sup>

Sanusi further stated that:

‘When people say banks have failed, it’s like saying a man whose throat has been slit and you say the man died. He did not die, he was killed. And those that murder the banks, those that destroy these deposits have always walked away. They become senators. They become governors. They become captains of industry. They set up new banks and they continue, forgetting the millions of poor people who don’t have a voice. That’s it! Nobody knows the number of Nigerians who have died from failed banks because they were sick and could no longer pay their medical bills because the money was locked up in a bank that has failed. Nobody knows the number of children whose parents could very well afford to pay their school fees who had to drop out of school because banks were mismanaged’.<sup>896</sup>

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<sup>894</sup> Ibid

<sup>895</sup> Ibid

<sup>896</sup> Ibid

According to him, Nigeria lacks development because vested interests continue to rob the country of their assets. He believes that the only way Nigeria can move forward is to stop complaining and start working towards overcoming the fear of vested interests. He further explained that the master minds of these frauds are not very intelligent people, they are not to be feared and they have two powers only. First is 'How much do you want?' and if you refuse their bribe, they say 'I'm going to destroy you.'<sup>897</sup>

It can be said that the speech of the CBN governor is very rich in divulging the activities of Nigerian elites, who have contributed to the underdevelopment and corruption of the country. This shows that control fraud in the banking sector is but one of the series of frauds in the country. The question then is whether Nigeria can be purged of vested interests. Can these people be brought to book? Perhaps a good starting point is an attempt by every individual to participate in contributing their own share of promoting a corruption-free society. For the banking sector, this would mean that each corporate participant should strive to work towards promoting effective corporate governance and ultimately help to reduce the likelihood of future control frauds in the country.

## **9.5 Recommendations for Reform**

As seen throughout the course of this thesis, the level of corruption and fraud in Nigerian banks remain a reflection of the economic and socio-political environment. Nigeria as a whole is troubled with endemic corruption in all spheres of life, together with lawlessness and nepotism which could expose the corporate world and banking sector to corruption. It is good practice that potential investors satisfy themselves of the existence of strong business environment before any financial commitment. They therefore assess political, business and financial risks involved. Countries

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<sup>897</sup> Ibid



that fail to pass this obviously lose trade and attraction in trade and investment, having failed to establish standards of transparency, fairness and accountability which are the themes of good corporate governance.

Observance of sound corporate governance principles by Nigerian banks will promote efficiency, transparency, responsible and accountable banks and will ultimately control fraud.

In view of this, two major recommendations are suggested:

1. Given that the problem of regulatory multiplicity of corporate governance regulation creates opportunity for the perpetration of control fraud, it is recommended that regulatory bodies such as the CBN and SEC work together in the co-ordination of corporate governance codes to the effect that it gives one voice of unity and promotes teamwork in order to prevent future control frauds in Nigeria.
- 2.
2. Given that the codes in themselves are not enough to enforce effective corporate governance practices and reduce control fraud in the banking industry; it becomes imperative for each corporate actor to actively participate in enforcement of corporate governance codes and standards targeted towards fraud prevention and control in the Nigerian banking industry.

In this regard, a further set of recommendations is highlighted below:

- CEOs should be adequately educated and empowered as main agents in both corporate governance and control fraud. It is important that CEOs are provided with adequate resources and trainings, particularly on fraud prevention and effective corporate governance that would be useful in their role as CEO.

- Regulators, mainly the CBN should educate all corporate actors, namely CEOs, auditors, shareholders and even employees on the importance of promoting corporate governance regulation in Nigeria and emphasizing the need to work as a team in order to reduce control fraud in the country.
- The regulatory powers of the CBN and SEC should be strengthened in their supervisory oversight of banks. The CBN in particular should provide for a more effective licensing and monitoring strategy for banks, which should be strictly implemented, with the aim of enforcing corporate governance regulation in Nigeria and ultimately preventing future control frauds.
- Shareholders should be particularly educated to be actively involved and encouraged to participate in promoting effective corporate governance through attending of meetings and showing interest in the management of the company by asking questions where necessary and also educating them on ways to seek redress.
- Regulators should work together to harness their codes. The irregularities in codes should be addressed in order to prevent an avenue for future control frauds in the country.
- Corporate governance regulation should provide for personal liability of auditors as is the case with CEOs. This should create a sit-tight position for auditors in Nigeria.
- Independence of auditors (internal and external) and sub-committees should be promoted and other actors such as shareholders and other stakeholders should ensure that auditor independence is enforced in banks.
- Provision of non-audit services should be prohibited and this prohibition should be adequately enforced. At the very least there should be a requirement of detailed disclosure of the provision of non-audit services to audit clients, including the cost of those services in comparison to the cost of audit services.

- The number of independent non-executive directors should be increased. More independent directors should be involved on the board. There should be a clear and coherent definition of independence. Directors might be required to make statutory declarations of independence, with sanctions where those declarations are proven to be false. Consideration should be given to granting the CBN to vet the board's nominees. Shareholder associations might also be given the right to appoint an independent director.
- Strategic judicial reforms should be made by parliament to promote judicial independence and facilitate faster determination of control fraud cases.

## **9.6 The role of each actor in ensuring good corporate governance**

The subsections that follow will make specific recommendations for the role of each actor in enforcing corporate governance in order to prevent future control frauds.

### ***9.6.1 The CBN***

As recalled throughout this thesis, a large percentage of control fraud is blamed on the CBN's lack of regulatory oversight, especially in the access to the discount window. As a way forward, it is recommended that the CBN allows greater transparency and more disclosure. This is in a bid to erase the on-going doubts on its integrity.

Throughout this thesis, emphasis is placed on the failure of the CBN to publish the results of its special investigation conducted in 2009, which resulted in the removal of the CEOs of the five banks. The CBN was ordered by the court under the Freedom of Information Act to produce this information but yet refused and is still refusing to date. Nigerians are left to

wonder if and why the investigation took place at the time it did. It is important to mention that over emphasizing the CBN's refusal to produce the said documents will not yield any answers. What should be stressed however is the future of the CBN. The CBN has itself acknowledged regulatory failure; therefore a way forward is what is needed in the fight to prevent future control frauds.

Firstly, the CBN should draw more focus on its own internal control, particularly its licensing and scrutinizing regime. Banks should be thoroughly scrutinized as part of their registration process. Proper and stricter background checks and due processes should be followed before registration of banks. Furthermore, it is very important to reiterate that the CBN admitted during its presentations to the committee that part of the problems during the crisis was that the banks were in the habit of producing inaccurate (but audited) financial statements to the CBN of which it was ignorant.<sup>898</sup> This creates some possibilities: corruption or incompetence due to lack of adequate resources. If the CBN was unaware of this, then it can be said that perhaps it lacks adequate mechanisms to detect the fraud. As a way forward, it is therefore proposed that the CBN should be adequately resourced, first with strict scrutinizing regime to license banks, and second, with appropriate mechanisms to scrutinize financial statements presented by banks and in the case of EDW, there should be more clarity regarding what is accepted as collateral for the discount window and the CBN should be required to verify the legality or otherwise of these collaterals. The whole essence is to prevent future control frauds in banks. It is therefore recommended that the CBN should develop adequate enforcement mechanisms for compliance to the rules in place regarding the EDW.

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<sup>898</sup> See the House of Representatives Report Of The AD-HOC Committee On The Investigation Into The Near Collapse Of The Nigerian Capital Market, Resolution NO (HR70/2012) at p. 66.  
<http://proshareng.com/news/download.php?item=AdHocCommitteeonCapMktReport19%25200712.pdf> accessed 25 September 2013

Furthermore, the CBN should be adequately resourced to participate in the appointment of independent directors of banks by vetting nominees selected by the board. Independent directors as the name suggests must be independent of any affiliations with the bank that could pave way for the perpetration of control fraud; this is important if the CBN is to curb fraudulent activities such as excessive use of the discount window and granting of unsecured loans by the bank which are signs that control fraud are taking place. By participating in the selection process for independent directors, the CBN is, among other things, playing its role in promoting effective corporate governance and ultimately reducing the likelihood of future control frauds in Nigerian banks.

Lastly, it is also recommended that a Code of conduct should be in place that would require the CBN to make public matters that relate to the public, especially issues of control fraud. The CBN should also have guidelines for its governors and top officials that would allow them to be accountable for their actions with appropriate penalties for regulatory failures. This is to promote transparency and accountability. Good corporate governance is a collective effort and if reform is to be made, it should come from the top. The masters should prepare to serve.

### ***9.6.2 Auditors***

As explained earlier in the chapter on Auditors, the limitations of audit as a task itself no doubt suggests obscurity and marginal difference as to what is expected of an audit and what audit actually produces. It could also be the case that auditors might be victims of control fraud, having absolutely no knowledge of what goes on behind closed doors; however, this is not the case of the auditors of these banks, as the EFCC had actually suspected collaboration and conspiracy between these auditors and the CEOs but sadly none of these auditors have been indicted. The public was led to believe that drastic steps were being taken to bring the culprits to book. However, while

this can be said of the CEOs and members of management staff and internal audit committees that were involved, very little can be said of the external auditors involved in the crisis. What the Regulators and EFCC merely did was to invite the auditing firm from time to time for a hearing without any further prosecution. It is important to also mention here that there is no conclusive evidence that the auditors are guilty, what is being stressed is a problem of inadequate regulatory oversight.

While we are aware that there is no law in Nigeria that allows for personal liability of auditors, the disciplinary tribunal of ICAN has the status of a federal high court.<sup>899</sup> As mentioned in the chapter on Auditors, to date, the involvements of audit firms in the banking crisis have not been investigated by ICAN, neither has it indicted any of its members. Over time, there has been a questionable silence on the part of the auditors, despite constant demand for questions by the public and media on why the auditors have not been questioned. A good recommendation in this regard, would be for personal liability of auditors to be enforced. This will serve to provide for adequate checks and balances for auditors and in effect help reduce the likelihood of auditors and audit committees collaborating with CEOs in the perpetration of control fraud.

It is also recommended that adequate enforcement of the ban on non-audit services in Nigeria should be promoted. At the very least, wherever non-audit services are provided, this should be disclosed in detail, particularly in terms of costs in comparison with audit services. This is because the provision of non-audit services may give auditors short-term incentives which lead them to engage in unethical practices and pave way for control frauds. The present CBN Code clearly lists the services to be banned and these have been discussed in chapter seven in auditors. If the country is to improve corporate governance in banks, every actor should contribute and it

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<sup>899</sup> See the establishing clause in the Preamble to the ICAN Act

is recommended that prohibition of non-audit services should be catered for in terms of enforcement and disclosure in a bid to promote auditor independence and ultimately ensure effective corporate governance.

Also the provision of internal control should be strengthened for auditors as well. The internal regulation of auditors would mean it is harder to perpetrate control frauds. It is important that auditors are constantly monitored by their regulating bodies, such as ICAN, and issues of concern should be addressed in-house in a bid to ensure adequate checks and balances.

Tenure of auditors as stressed in the present code should also be adequately enforced. Regulators should see that auditors are not over re-elected as this may impact on their independence. It is not enough to list provisions in the code but the zeal to enforce them proves its efficiency. It is important to say that if the code fails for instance and another wave of frauds occur, the CBN will bring forward another code, supposedly a more rigid one with tougher sanctions. This will continue to go on and on and the country will be left in a circle where frauds have become endemic. Perhaps, an understanding of this is necessary to inform actors of the need to play their part in corporate governance regulation.

### ***9.6.3 CEOs and Board of Directors***

With respect to the CEOs, this chapter has recapped the present regulations in place to curb the excesses of CEOs in Nigerian banks. The CEOs are very important actors in corporate governance. The essence of this research is to uncover the activities of the CEOs during the banking crisis and it is therefore important that they are well regulated if control fraud is to be reduced in Nigerian banks. Being the persons charged with the day-to-day running of the bank, the CEOs are constantly presented with an opportunity to commit fraud, whether or not this opportunity or thought can be carried

out depends on the regulatory measures in place and their ability to work round these measures.

Firstly, packages which create perverse incentives should be abolished. There is no provision in the current codes that gives room for this; however, the trend of using monetary rewards to boost share price in itself encourages fraud. In Nigeria, CEOs are generally known to be affluent, with many of their riches coming from the banks, they are seen as rewards for good performance, despite the contrary provisions in the codes. It is problematic to continue this ongoing trend of monetary rewards. A good recommendation would therefore be for further research on the incentive effects of pay leading to fraud in order to boost share price, and for some kind of regulation of these pay practices to be introduced (as they have been in the EU).

It is also important to look into board size and composition. Clearly Chairman/CEO duality has been abolished after the crisis and it is no longer an issue. What should be stressed however is the composition of board of directors, particularly, the Non-Executive directors and Independent directors. The composition of these groups of people should be from adequate qualifications and experience. In this regard, family ties should not be the sole criterion. It is important that appropriate background checks should be made before their appointment. A clear and coherent definition of 'independence' should be adopted and more numbers of independent non-executive directors should be encouraged on the board. Furthermore, statutory declarations of independence should be required by directors with sanctions for non-compliance and false declaration. This is to ensure higher standards of checks and balances and also promote independence. Another issue that should also be considered, taking into account Nigeria's specific culture, is adequate share of tribe. Without being prejudiced, it is very important that at every point in time, Nigeria is adequately represented if possible with members of different tribes to ensure transparency and



accountability. This is necessary because of the cultural differences in the country. It therefore follows that people of the same tribe have a higher tendency to cover up for one another at workplaces, whereas the tendency of this with people of different tribes is lower. The country should be prepared to create a more professional working environment made up of people that are determined to make change happen and not an environment filled where everybody has an eye on the national cake. Tribal balance is therefore recommended in this regard.

Education of CEOs and board members is also important. Constant training and conferences aimed at improvement should be encouraged. In Nigeria, this was another lucrative means of fraud, where a large amount of money was invested in training and conferences that never happened. Again accountability would solve this problem. It is important that the results of training and educational programmes are demanded from CEOs and board members to the effect that the company is satisfied that they have taken place. Merely stating in the annual report a large amount of money spent on staff or CEO training is not enough. More evidence should be provided that the training actually took place, for example, through certificate of attendance.

#### ***9.6.4 Shareholders***

Shareholders rights and responsibilities under Nigerian law cannot be overemphasized. The 2007 code for shareholders have explicitly stated the duties and functions of shareholders. It was meant to educate shareholders, particularly passive and minority shareholders of their rights.

However, it was not until the financial crisis of 2009 that shareholders started exercising these rights, demanding answers from both regulators and board of directors. The provision of shareholder associations and encouragement of shareholder activism should be further strengthened in

Nigeria. Shareholder participation in corporate governance must be encouraged if Nigeria is to reduce control fraud in banks. A good recommendation is that shareholders be involved in appointment of independent directors. This will serve as a means of checks and balances, and also help to promote effective corporate governance.

Furthermore, it is important that shareholders should be better educated and encouraged to attend meetings, ask questions and be aware of the financial situation of the banks. No doubt the day-to-day running of banks is the job of directors; however it is important that shareholders should know the banks' financial situation. This then also poses a problem that they can only know what is being told to them, true, but constant checks and balances will serve to protect their interest and in the case that they suspect any irregularity, this can be flagged up to the appropriate body such as the CBN. There is no gainsaying that shareholders are still largely unaware of their rights and privileges; some of them who are aware, are even scared to speak up. The chapter on shareholders examined the activities of shareholders during the financial crisis and how the judiciary was manipulated by the CBN to suppress the demands of the shareholders. Shareholder education is therefore very important and should be encouraged if shareholders are to be involved in promoting effective corporate governance regulation in Nigerian banks.

Adegbite, Amaeshi and Amao consider the extent to which a country's local shareholder activism is a reflection of its political culture.<sup>900</sup> They describe shareholder activism as a corporate governance accountability measure, whether at the managerial or board level.<sup>901</sup> Shareholder activism consists of a variety of activities through which shareholders influence the management and board. This can be in the form of meetings, letter-writing

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<sup>900</sup> Adegbite, E, Amaeshi, K. and Amao, O. (2012) 'The Politics of Shareholder Activism in Nigeria' 105 *Journal of Business and Ethics* 389-402

<sup>901</sup> Ibid 391

or associations as the case may be.<sup>902</sup> Gillian and Starks consider a shareholder activist as an investor who, through his voice, endeavours to change situations of concern, while not necessarily resulting to change in the firm's control.<sup>903</sup>

Shareholder activism in Nigeria has been influenced by the political culture of the country. Corruption has mainly been a drawback for Nigeria since Independence and seems to have eaten deep into spheres of the economy, including the corporate sector. That notwithstanding, the misuse of shareholder activism by members tends to create a threat to the organisation.<sup>904</sup> The manner by which shareholder associations tend to exercise their rights, with activities such as bullying and boycotting of AGMs becomes a concern.

According to Adegbite, Amaeshi and Amao, some members of shareholder associations have expressed their concern on the way some of their members conduct themselves through negative publicity arising from threats and disruptions of meetings.<sup>905</sup> A good recommendation would therefore be to educate shareholders on the relevance of shareholder associations, particularly in protecting shareholders by giving them a voice of unity and also to work together in the effective management of the company. The role of shareholders as investors is paramount and should not be limited to simply received dividends and capital gains.

Another important recommendation is the enlightenment of shareholders on the danger of pushing for short-term gains in the company, the result of which could lead to CEOs engaging in accounting malpractices and

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<sup>902</sup> See Beeth, M. Franks, J, Mayer, C and Rossi, S. (2009). 'Returns to Shareholder Activism: Evidence from a clinical study of the Hermes UK Focus Fund.' 22(8)*The Review of Financial Studies* 3093-3129

<sup>903</sup> Gillian, S.L., and Starks, L. T. (1998) 'A survey of Shareholder Activism: Motivation and empirical evidence.' 12(3)*Journal of Corporate Finance* 275-305

<sup>904</sup> Adegbite, Amaeshi and Amao Ibid

<sup>905</sup> Ibid

ultimately control fraud. Shareholders should be educated on the need to work together for the efficient running of the company and they should not be so preoccupied in their financial gains, which may be to the detriment of the company.

### **9.7 Summary and Conclusion: Contribution to theory, practice and policy**

This thesis addressed corporate governance and control fraud in Nigerian banks, using the first five distressed banks as a case study. The thesis identified control fraud as an endemic problem peculiar to Nigeria's institutional corruption which contributed to a number of factors that led to the banking crisis of 2009. The research examines the CEO as a financial super predator who uses regulatory weakness of corporate governance as a vehicle for fraud. As the main agent in control fraud, the CEO perpetrates fraud in collaboration with other individuals in the corporate web, such as board of directors, shareholders and auditors. The use of the theory of control fraud to understand the 2009 banking crisis in Nigeria can be said to be a peculiar contribution to theory, the first of its kind in Nigeria. The research therefore makes theoretical contribution by using the banking crisis to analyse and examine corporate governance as a driver of control fraud

Furthermore, the thesis is relevant to policy on corporate governance regulation in Nigerian banks. The thesis stressed the need to improve regulatory enforcement if control fraud is to be reduced in Nigerian banks. The problem of enforcement was stressed throughout the research to point that regulatory reform is required in corporate governance that will take into account the problem of institutional corruption in the country and the need for each corporate participant to play their role in enforcing corporate governance if control fraud is to be reduced in Nigerian banks. It is recommended that regulators such as the CBN and SEC, as well as corporate actors including shareholders, auditors and board of directors

work collectively to promote effective corporate governance in Nigerian banks. The recommendation of a 'team work' approach is a positive contribution to policy and practice for effective corporate governance and ultimate reduction of control frauds in Nigerian banks.

The recommendations suggested in this research can be said to be a bold step in the race towards a fraud-free environment for Nigerian banks. The research concludes that Nigeria is a country with its own specific culture in terms of development and socio- economic advancement. It is therefore important that the country strives to attain international best standards of corporate governance if it is to promote investments and retain confidence to its financial sector. Eradicating or at least reducing control fraud through enforcement of corporate governance regulation will certainly go a long way in this and it is important that investors are convinced that the country is financially stable.

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