

The Consequences of Disclosed Fraud in the Libyan Banking Sector

Mohamed Issa

Graduated from University of Benghazi, Faculty of Economics, Libya

***Corresponding Author:** *Mohamed Issa, Graduated from University of Benghazi, Faculty of Economics, Libya*

Abstract: *Fraud is rife in different sectors in Libya. That led many firms to make control mechanisms to anti-fraud in the country. This paper studied the consequences of disclosed fraud. Data were collected through a prepared questionnaire based on Libyan environment and 200 valid responses have been analyzed through SPSS. The results of the study indicated that fraud cases increase even there are strict rules. Moreover, the disclosed fraud causes negative effects on the behavior of employees in the banks and it may encourage them. Finally, the conflicts in the country might cause the fraud and punishment system may be needed to be changed.*

Keywords: *Forensic Accounting, Fraud, Banks and Performance*

1. INTRODUCTION

Fraud is a highly complex phenomenon that affects social, political and economic lives. The number of reported frauds against individuals has increased in last decades (Engels, 2020). Libya faces sizable dilemma of fraud cases, also, there are many forms of fraud has been committed in different sectors in Libya.

Furthermore, fraud can also lead to a loss of trust and confidence in the financial system. This can result in investors becoming hesitant to invest in firms or even the entire market, which can have a ripple effect on the economy. (Chang & Chang, 2012).

Additionally, fraud can damage the reputation of firms and individuals involved, leading to long-term consequences such as difficulty obtaining financing or job opportunities. Moreover, fraud can have social implications as well. It can lead to a sense of injustice and inequality among those who are affected by it. It can also contribute to a culture of dishonesty and unethical behavior, which can be detrimental to society as a whole.

Overall, the effects of fraud are far-reaching and damaging. It is important for individuals and firms to take steps to prevent and detect fraud in order to protect themselves and their communities from its negative consequences.

Fraud has wasted many investment opportunities in the country. Therefore, Libyan Banks have implemented many practices to control wrongdoings, also, they have made strict control to detect and prevent fraud.

Hagen and Malisa (2022) clarified that a person who has the availability of colossal data sets mostly does fraudulent cases. Some banks have used different techniques to detect, prevent and report fraudulent acts. While other banks have improved their own techniques to do so. However, all these techniques have led Libyan banks to flounder at different levels and caused instability in the country. In addition, fraud or any kind of scheme may cause opposite outcomes once it discovers or reveals (Richardson, Obaydin & Liu, 2022).

2. LITERATURE REVIEW

2.1. Fraud

Fraud can take many forms, including embezzlement, bribery, insider trading, and money laundering, while the harmful one happened when a higher position acts of using power for personal gain in a manner that breaks the law (Nguyen and Dijk, 2012). It can occur in both the public and private sectors, affecting businesses of all sizes and government agencies at all levels. The consequences of fraud can be devastating, leading to financial losses for individuals and firms.

Nowadays, fraud become very complicated, because of the increases and integration in business, which made it difficult to be detected. Therefore, many organizations and individuals have asked professionals to deal with such issues.

2.2. Fraud Elements

There are various motives that may drive fraudsters to seek an increase in their wealth or profits. In addition, fraud can be committed in different forms but there are three basic elements of committing fraud and they were called the fraud triangle as in figure (01).



Fig1. Fraud Triangle

Source: "Forensic Fraud", Turvey, 2013, Page 24

By criminologist Donald Cressey in the 1950s. The theory suggests that three key elements must be present for fraud to occur: pressure, opportunity and rationalization. Pressure refers to the external or internal factors that motivate an individual to commit fraud, such as financial difficulties or a desire for personal gain. Opportunity refers to the ability of an individual to commit fraud due to their access to resources or information. Rationalization involves the justification or excuses an individual uses to convince themselves that committing fraud is acceptable.

The fraud triangle theory has been widely accepted and used in various industries. It has also been expanded upon by other researchers who have identified additional element that contribute to fraudulent behavior, it was called "ability" to the previous fraud elements. It was introduced by Wolfe and Hermanson (2004).

Therefore, it was renamed to Fraud Diamond as in figure (02). In addition, they believed that fraud requires a certain level of knowledge, skills and access to resources in order to be successfully executed. Without these elements, it would be difficult for someone to carry out a fraudulent act.

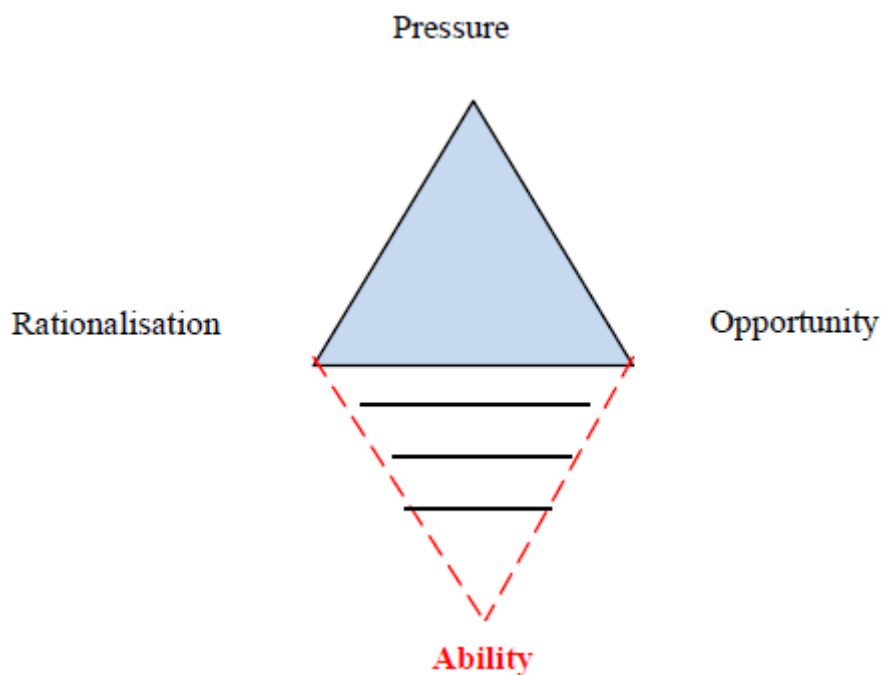


Fig2. Fraud Diamond

Source: Wolf and Hersmanson, “The Fraud Diamond: Considering the four elements of fraud”, *The CPA Journal*, 2004, Page4

2.3. Types of Frauds

Cyber fraud has become increasingly prevalent in recent years due to the rise of online transactions and the widespread use of credit cards for purchases. Online credit card theft occurs when a hacker gains access to someone's credit card information or by hacking into a company's database that stores customer information.

In addition, the most common committed fraud in Libya is theft fraud. It is committed by stealing money or assets. Moreover, it follows this kind of fraud is an intentional act of falsification to hide the occurred fraud. This action leads to misrepresentation of the financial statements.

Moreover, there is fraud is called white-collar crime, which committed by high managers, also it is one of the high common frauds that have occurred increasingly in Libya. However, sociologist Edwin Sutherland first defined it in 1939 as a crime committed by a person of respectability and high social status. ACFE (Association of Certified Fraud Examiners) made a study (2022) showing the most position in the firm commit fraud and the figures (03 & 04) below show that:



Fig3. Perpetrator's level of authority relate to occupational fraud in the United States and Canada

Source: Association of Certifies Fraud Examiners report (ACFE), 2022, Page83

Figures 03 and 04 show respectively the median loss of committed frauds in the USA and Canada and Middle East and North Africa based on the fraudster's position. The costly frauds were committed by higher levels of authority in the USA. In addition, there were big numbers of financial losses committed by managers as it shows in the figures. Even there were discrepancies between these regions in the cultural, political system and economic systems in them, yet, there is a strong correlation between them in costs of the fraud and positions in the firms.

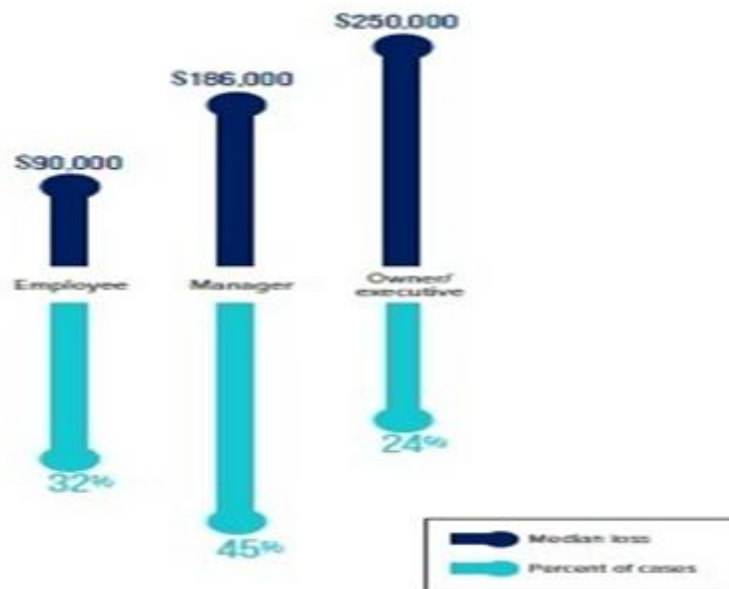


Fig4. Perpetrator's level of authority relate to occupational fraud in the middle east and north africa

Source: Association of Certified Fraud Examiners report (ACFE), 2022, Page 77

3. PRACTICAL STUDIES

Wu, Chang, li & Zhu (2022) analyzed financial fraud through the effectiveness of audit opinion or the correlation between auditor change rate and financial fraud, ignoring the relationship between different participants. This paper constructs an audit information knowledge graph and proposes a knowledge graph reasoning framework based on the Sub Feature Extraction method to detect potential fraud corporations. In the process of analyzing the audit data of 376 firms in the China Growth Enterprises Market from 2013 to 2019. It was found that potential fraud corporations can be well identified by searching from the known fraud corporations using searched paths.

Suh, Nicolaides & Trafford (2019) attempted to measure the relationships between the perceived opportunity reduction and other fraud risk factors with regard to the likelihood of fraud occurrence in financial institutions. In this study was gathered 395 survey responses from South Korean financial sector. The data were analyzed by using logistic regressions of control mechanisms combining prevention and deterrence measures (the qualitative aspect of internal control), is more important for preventing fraud than the mere existence of many anti-fraud controls. Finally, it was resulted that the employees of the Korean financial institutions view that the risk of management override of controls is a more critical risk than collusion in their organization.

Rahman and Anwar (2014) made a study to identify the common types of bank fraud on Islamic banks in Malaysia and to improve the effective fraud prevention and detection methods using protection software. Finally, it resulted that fraudulent statement is the frequent type frequently occurred and followed by credit card fraud in Islamic banks.

Handley and Mohamed, (2014) examined the potential means available to firms' managers, auditors, and regulators for preventing, detecting, and reacting to financial statement fraud in Malaysian. They used interviews with firm managers, auditors and regulators in their study. It was found that management integrity and the development of internal systems to prevent fraud reporting was very high. However, regulators reduce the probability of financial statement fraud. Regulations that were set to deter and react to cases where such frauds are detected helped to reduce the number of the cases.

4. RESEARCH RATIONALES AND MOTIVATIONS

The issue of fraud has become the first issue in the world, because it causes of a big destruction in the economy of the countries. In addition, fraud issue led to many discussions about applying strict methods to eliminate this issue. Therefore, it is important to establish an effective fraud detection and prevention methods, because they can reduce the opportunities of fraud from happening.

Many studies regarding fraud approved that fraudulent behavior is a worldwide issue (Suh, Nicolaidis and Trafford, 2019). In addition, the majority of the studies have studied the effects of the fraud on the firms and the countries and the ways to detect and prevent frauds.

Fraud has become a major problem in Libyan banks, according to The Audit Bureau there is suspicion of fraud in Libyan banks. In addition, Libya was ranked 172th out of 180 countries on Transparency International's 2022 corruption perception index.

Despite the efforts for facing the fraud, the fraud rate has increased due to the interaction of economic, social, political and administrative factors in Libya. Therefore, the main question of this research is, "what are the consequences of disclosed fraud in the Libyan banking sector?"

5. REREACH METHODOLOGY

For data collection, a questionnaire was distributed using a random sample of employees in the Libyan banks during the period from August to December 2022. A total of 200 responses were collected. The Libyan Banks were included in the sample; Wahda Bank, Jumhouria Bank, National Commercial Bank, Bank of Commerce & Development and Sahara Bank. These are banks are located in the east part of Libya and cannot study all banks in different parts of the country, due to the security issue. A prepared questionnaire was structured to serve the purpose of the study based on Libyan environment. The questionnaire consists of 29 questions, which were divided into four sections.

| Field of study | Number |
|---|--------|
| General Questions | 5 |
| Fraud Awareness | 7 |
| Anti-Fraud Procedures | 11 |
| Effects of Fraud Detection and Disclosure | 6 |

6. RESULTS AND ANALYSIS

This section shows the major findings and ties them with the research a main question. This research addresses the following points, fraud awareness, anti-fraud procedures and effects of fraud detection and disclosure. The following parts discuss and summarize the major findings of the study in order to determine the effects of fraud detection and disclosure in Libyan banks. This table shows the personal information about the participants.

6.1. The Sample Description

Table1. General Information about the Participants

| Questions | N | Percentage | |
|----------------------------------|------------------|------------|-------|
| Position | Employee | 74 | 37 % |
| | Manager | 83 | 41.5% |
| | Executive | 23 | 11.5% |
| | Other | 20 | 10% |
| Gender | Male | 98 | 49 % |
| | Female | 102 | 51 % |
| Level of Education | Bachelor Degree | 75 | 37.5% |
| | Master Degree | 51 | 25.5% |
| | Doctorate Degree | 28 | 14% |
| | Other | 46 | 23% |
| Experience | 0-5 years | 8 | 4 % |
| | 6-10 years | 17 | 8.5% |
| | 11-15 years | 66 | 33 % |
| | More than 15 | 109 | 54.5% |
| Number of Training Course | No One | 19 | 9.5% |
| | One Course | 36 | 18% |
| | Two Course | 77 | 38.5% |
| | More than two | 68 | 34% |

Table 1 showed that the big number of participants were managers (41.5%) than employees (37%), while the executive were 11.5%. The majority of the participants were females 102 (51%) and 98 (49%) were males. Most of the participants hold a bachelor’s degree (37.5%) while (25.5%) had M.S degree. Participants who had Ph. D were (14%). (4%) have experience between 1-5 years whereas (8.5%) have 6-10 years of work experience. The percentage of employees who have experience from 11-15 years were (33%) and the majority of employees who worked more than 15 years were 54.5%. Furthermore, the vast majority were (38.5%) who had taken two training courses for anti-fraud while the employees who have taken more than two courses for anti-fraud were (34%) and 18% were have taken one course.

Table2. *Fraud Awareness*

| Q | Statement | Percentage | | Std. |
|----|---|------------|----------|-------|
| | | Agree | Disagree | |
| 6 | My Bank has been a victim of frauds | 93% | 7% | 0.256 |
| 7 | Aware of the wrong process of the existence and possible fraud | 74% | 26% | 0.440 |
| 8 | Internal auditors play an important role in detecting fraud | 98.5% | 1.5% | 0.122 |
| 9 | Frauds are usually detected from internal auditors | 87% | 13% | 0.337 |
| 10 | Capable to notify the right party about discovered fraud | 89.5% | 10.5% | 0.307 |
| 11 | Capable to Use technology to gather data and investigate fraud symptoms | 98.5% | 1.5% | 0.122 |
| 12 | Management plays an important role to fight Fraud | 99.5% | 0.5% | 0.071 |

Table 2 shows the percentages of participants’ opinions about the fraud awareness. The table shows that 93% in the agree side that their banks have faced fraud cases. The 74% of the participants were aware of process of existence and possible fraud, while 26% of participants did not have knowledge of the process. The 98.5% of participants believed that the internal auditors play an important role in detecting fraud. 87% agreed that the internal auditors have detected the fraud in the bank. The 89.5% of participants were capable to notify about discovered fraud. In addition, the 98.5% of participants were capable to use technology to gather data and investigate fraud symptoms. The 99.5% of participants believed that the management does its best to fight Fraud.

Table3. *Anti-Fraud Procedures*

| Q | Statement | Percentage | | Std. |
|----|---|------------|----------|-------|
| | | Agree | Disagree | |
| 13 | Fraud prevention and detection training | 98% | 2% | 0.140 |
| 14 | Internal control review and improvement | 91.5% | 8.5% | 0.280 |
| 15 | Increased role of audit committees | 74% | 26% | 0.440 |
| 16 | Surveillance equipment | 94% | 6% | 0.238 |
| 17 | Surveillance of electronic correspondence | 85% | 15% | 0.358 |
| 18 | Staff rotation policy | 99.5% | 0.5% | 0.071 |
| 19 | Inventory observation | 95.5% | 4.5% | 0.208 |
| 20 | Cash reviews | 84.5% | 15.5% | 0.363 |
| 21 | Organization used of forensic accountants | 96% | 4% | 0.196 |
| 22 | Virus protection | 86% | 14% | 0.348 |
| 23 | Password protection | 97% | 3% | 0.171 |

Table 3 shows that high percentage of participants’ perception indicated that the banks have implemented procedures for anti-fraud. Hence, there is tangible actions to detect and prevent fraud. All the tools for that, the banks have implemented them in their banks.

Table4. *Effects of Fraud Detection and Disclosure*

| Q | Statement | Percentage | | Std. |
|----|--|------------|----------|-------|
| | | Agree | Disagree | |
| 24 | The number of fraud cases increases after the strict regulations | 82.5% | 17.5% | 0.381 |
| 25 | Disclosed fraud has negative effects on the behavior of employees in the bank | 97% | 3% | 0.401 |
| 26 | Disclosed fraud motivates others to do so | 99% | 1% | 0.171 |
| 27 | Because of political issues, social division, and no control, fraud is a way to the conflict | 99% | 1% | 0.100 |
| 28 | Because of political issues, social division and no control, fraud is an opportunity | 100% | 0% | 0.100 |
| 29 | Kind of punishment for fraudsters encourages others to do so | 98.5% | 1.5% | 0.000 |

Table 4 shows that high percentage of participants thought that the number of fraud cases increases after the strict regulations. Moreover, the participants agreed that the disclosed fraud has negative effects on the behavior of employees in the bank which, mainly hurts the system in the banks. The majority of participants was generally agreed about the effects of disclosed fraud which motivates others to do. In addition, there was awareness among the participants regarding political issues, social division and no control in the country, which lead to make the fraud is a way to the conflict. Moreover, the political issues, social division and no control in the country might cause the fraud is an opportunity. Thus, the perception of participants is higher in relation of the kind of punishment for fraudsters, which encourages others to do so.

7. CONCLUSION

The main goal of this research was to study the reasons behind the increase of fraud in banking sector even there have implemented strict rules in the sector. More specifically, the research investigates the abnormal reactions for bankers after disclosing a fraud case and the sanctions of that. Consequently, it is concluded that fraud will constantly happen no matter how hard strict systematic rules are implemented but the punishments and consequences can curb fraud.

Finally, the way to encounter this issue is by promoting a culture of compliance and ethical policy. This policy must not be a mere policy on the bank's wall. Only by practicing and installing good ethical behaviour in life, this moral issue can be overcome successfully. Therefore, it is the responsibility of the bank's management to improve their employees' awareness of fraud activities and enhance the bank's security system in order to minimize the cases that involved employees and managers.

8. LIMITATIONS AND FUTURE RESEARCH

This study investigated on internal fraud, which has limitations where the future studies should give more emphasis in deterring the external fraud within the banks. Furthermore, this study is all about developing countries and Libya specifically.

REFERENCES

- [1] Association of Certified Fraud Examiners (ACFE) (2022). Report of Nations on Occupational Fraud and Abuse.
- [2] Chang, Wen-Hsi & Chang, Jau-Shien (2012). An effective early fraud detection method for online auctions. *Electronic Commerce Research and Applications*.
- [3] Coderre, David (2009). *Fraud Analysis Techniques Using ACL*. 1ed, Wiley & Sons, Inc, Canada.
- [4] Engels, C., Kumar, K., Philip, D., 2020. Financial literacy and fraud detection. *Eur. J. Finance* 26 (4–5).
- [5] Hagen, Johannes and Malisa, Amedeus (2022). Financial fraud and individual investment behavior. *Journal of Economic Behavior and Organization*, page 593–626.
- [6] Handley, Moorison, Mohamed, Norazida (2014). Financial statement fraud risk mechanisms and strategies: the case studies of Malaysian commercial firms. *Social and Behavioural Sciences*.
- [7] International Professional Practices Framework (IPPF) (2014). *Fraud Detection Using Data Analytics in the Banking Industry*.
- [8] Kassem, Rasha and Higson, Andrew (2012). The New Fraud Triangle Model", *Journal of Emerging Trends in Economics and Management Sciences*.
- [9] Nguyen and Dijk, (2012). Fraud, growth, and governance: Private vs. state-owned firms in Vietnam", *Journal of Banking & Finance*.
- [10] Rahman, R. Abdul and Anwar I.S. Khair (2014). Types of Fraud among Islamic Banks in Malaysia", *International Journal of Trade, Economics and Finance*.
- [11] Richardson, Grant, Obaydin, Ivan & Liu, Chelsea (2022). The effect of accounting fraud on future stock price crash risk. *Economic Modelling*.

- [12] Suh, Joon, Nicolaides, Rebecca and Trafford, Richard (2019). The effects of reducing opportunity and fraud risk factors on the occurrence of occupational fraud in financial institutions. *International Journal of Law, Crime and Justice*, Volume 56, PP 79–88.
- [13] Wolfe, David T. and Hermanson, Dana R. (2004). The Fraud Diamond: Considering the Four Elements of Fraud”, *CPA Journal*.
- [14] Wu, Huidong, Chang, Yanpeng, Jianping, li & Zhu, Xiaoqian (2022). Financial Fraud Risk Analysis Based on Audit Information Knowledge Graph. *Procedia Computer Science*, Volume 199.

AUTHOR’S BIOGRAPHY



Mohamed Issa, Graduated from University of Benghazi, Faculty of Economics, department of Accounting in spring 2005. Then, he completed his Master’s Degree in Accounting from Middle Tennessee State University, Business School, department of Accounting, spring 2011. He completed his Ph.D in Business Administration (Specialized in Accounting) from Okan University in 2017. He is a faculty member in the department of Accounting at University of Benghazi. He has an interest in the field of forensic accounting, auditing and accounting education.

Citation: Mohamed Issa. "The Consequences of Disclosed Fraud in the Libyan Banking Sector" *International Journal of Humanities Social Sciences and Education (IJHSSE)*, vol 10, no. 7, 2023, pp. 131-138. DOI: <https://doi.org/10.20431/2349-0381.1007015>.

Copyright: © 2023 Authors. This is an open-access article distributed under the terms of the Creative Commons Attribution License, which permits unrestricted use, distribution, and reproduction in any medium, provided the original author and source are credited.