# FRAUD CONTROL STRATEGIES IN THE PUBLIC AND PRIVATE SECTORS AND ITS IMPLICATIONS FOR CORPORATE GOVERNANCE

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## Abstract

Fraud can be described as a conscious premeditated action of a person(s) with the intention of altering the truth for selfish monetary or non-monetary gains. Fraud includes embezzlement, theft or any attempt to steal or unlawfully obtain the assets of an organisation. Fraud has eaten deep into the fabrics of the Nigerian Society. Everybody is talking about fraud as if the fraudsters are from the moon. There is a saying that the old woman should stop telling stories of how the goat ate the yam when everybody went to the farm. But, she should stop the goat from eating further yam. Strong financial pressure motivates people to commit fraud once the opportunity avails itself. Thereafter they try to find justification for the fraud, forgetting that the 'food gained by fraud tastes sweet to a man, but he ends up with a month full of gravel' Prov. 20:17 (NIV).

## Introduction

Fraud is n legal concept and like all concepts, it suffers from definitional problems Iorsase, (2004:1). There is nowhere it is specifically defined in our legislations. Several statutes in the country create offence of fraud and of fraudulent conduct without expressly defining the term. It will not be possible to lay a hard and fast definition that comprehends fraud in all its ramifications. Fraud is infinite. It is like the elephant, easier to recognise than it is to define. Arising from this handicap position, we shall have recourse to the common Law definition of fraud in treating the subject.

In common law, fraud is a generic term embracing all multifarious means, which human ingenuity can devise and which are resorted to by one individual to get advantage over another by false suggestions or by suppression of truth, it includes all forms of surprise, trick, cunning, dissembling and any unfair way by which another is cheated. According to lorsase (2004, 1-2), fraud is an intentional perversion of the truth whether by word or by conduct, by false or misleading allegations or by concealment of that which should have been disclosed which deceives or is intended to deceive another so that he shall act upon it to his legal injury.

According to the International Auditing Guidelines (IAGS) now International Standards on Auditing, fraud is defined as a "mis-representation of financial information by one or more individuals amongst management, employees or other third parties". Fraud involves the use of criminal deception to obtain an unjust or illegal advantage. It covers all acts, omissions or concealments calculated to deceive whether it be a simple act or combination of circumstances, whether the suppression of truth or suppression of what is false, whether it be direct falsehood or gesture. Fraud is characterized by bad faith, dishonesty, unfairness, faithlessness, perfidy, etc.

## Classification of Fraud

The conditions in which fraud can occur differ from one situation to the other. The style, forms and methods of perpetrating fraud is expanding daily due to changes that have also taken place in the social, demographic and more importantly in the technological developments. Notwithstanding its diversity, Wells (1997; 2) classifies fraud under three broad categories, namely: occupational .fraud, organisational fraud and confidence schemes.

### Occupational Fraud

Occupational fraud and abuse are the various kinds of frauds that occur in the work place whereby a staff, employee, chief executive uses his occupation and position for personal enrichment through deliberate misuse or misapplication of the organisations resources or assets. This nature of fraud raises its head through embezzlement, misappropriation of assets, even conflicts of interests, etc.

### Organisational Frauds

Organisational frauds are deliberately planned and executed by organisations, either as a response to competition or to precipitate a take-over. Organisational frauds can find its way in product piracy/counterfeiting, industrial espionage and information brokerage, theft of intellectual property, etc.

**Confidence Schemes**

Confidence schemes are the kinds of frauds that are perpetrated by one individual against another in any kind of relationship or dealings whether commercial or social — where trust and confidence are the cornerstones. The deceiver takes advantage of the trust and confidence reposed in him to make a fraudulent misrepresentation, which the victim relies upon and suffers damage. Perpetrators of these kinds of fraud are loosely referred to as 'conmen'. Examples include advance fee fraud 419 schemes; illegal land deals, marital frauds, etc.

Deception is the centra! theme in any category of fraud. Somebody tries to con somebody else; or to manipulate the system unlawfully to their own advantage so that things come incredibly easily. The victim of such deception could be an individual or organisation.

For deception or fraud to exist, the following four elements must be present:

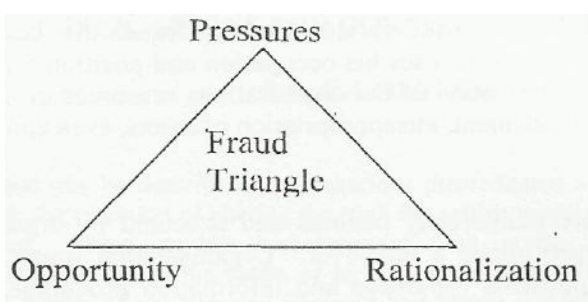
1. A material false statement;
2. Knowledge that the statement was false when it was uttered;
3. Reliance on the false statement by the victim; and
4. Damages as a result.

**Classification of Perpetrators**

Alande (2000:3) grouped fraudsters into several classes:

1. Hard-core criminals who set out primarily to defraud. To them, it is a normal business.
2. Straight guys who will bend through hard times financially or need to sustain their conspicuous consumption pattern.
3. People in search of excitement who find it thrilling to beat the system, i.e. those that write virus and off-load into the computer.
4. Those who are influenced by:
   (a) Societies' value system that give room for rat race for materialism best houses, best cars, best wives, etc.
   (b) Expectation syndrome from family members or kinsmen.
   (c) The bad company they keep.
   (d) Feeling of insecurity of job or frustration.
   (e) Those with hereditary tendencies to defraud i.e. anything related to the snake must be long and also engage in zig-zag movement.

**Causes of Fraud**




**What are the Causes of Fraud?**

The assumption as to why people commit fraud and why they are overcome by fraudulent intent is explained by the "Fraud Triangle" (lorsase, 2004: 3). One leg of the triangle represent strong financial pressure. The second leg is perceived opportunity to commit and hide the act. The third leg is for rationalization or justification for the fraud.

**Pressures to Commit Fraud**

In the work place, there are financial pressures that confront people in positions of trust. Often they are not able or open enough to disclose these problems to persons who will offer objective views to resolve the problems. This nature of pressure is also referred to as non-sharable problems.

Examples of this nature of pressures are financial losses, high personal debt, living beyond one's means, greed, real property acquisition in choice areas, extended family expenses. These problems put pressure on the fraudster to violate the position of trust.

This nature of problem rears its head through work related pressures such as job dissatisfaction, being overlooked for promotion, not adequately recognised for job performance, etc. There is no doubt that living beyond one's means and greed are llic motivators of this pressure.

**Opportunity to Commit Fraud**

Inadequate or deficient internal controls may create opportunities to commit fraud by the employees (whether they are managers or operatives) or even by the company itself. The fraudster must have the opportunity to commit fraud, hide the fruits of the crime and avoid being punished for the anti-social behaviour. If pressure is there and there is no opportunity, fraud cannot occur. There are three opportunities for the fraud event. These are:

(i) Lack or circumvention of controls that prevent and/or detect fraudulent behaviour.
(ii) Inability to judge quality of work.
(iii) Lack of disciplinary action.

There are at least three main elements in an organisation control structures which reduce the opportunity of fraud:

(a) The control environment;
(b) The Accounting System; and
(c) Control procedures and activities.

Management's role and example set the control environment. If the manager is dishonest and -fraudulent the employees will follow suit. Management must communicate what is right and appropriate. This nature of communication is important in controlling fraud. Communication must be consistent, in order for it to be effective.

The manner and procedure of staff employment must be taken with extra care. It is important to have a background check on new employees before they start work or before they are hired. It is advisable therefore for companies to conduct investigation on staff before they are engaged, otherwise some of them can spring surprises.

Any employee who has scaled the hurdle of background screening must be guaranteed by two responsible persons. One of whom is a member of the society, while the other should be a member of staff. These persons individually or jointly must be ready to execute the guaranteed bond.

When the organisational structure is not clear as to who is responsible for a given business activity, it can create opportunity for fraud. Therefore, people should know well ahead of time who is responsible for what. This being so, opportunity for fraud will be minimised.

Management must ensure that the internal audit in the organisation is effective. Audit must be continuous to be effective.

In an organisation, control procedures reduce the possibility of fraud. Therefore, preventive control measures such as segregation of duty should be in place, especially when cash is involved. Dual custody does not allow complete access to a transaction by one employee. Unless an individual is authorised to perform an activity, the opportunity to defraud is reduced. There should also be in place periodic job rotation. No one person should be allowed to remain in the same activity for too long. Other control measures that management should put in place include physical safeguards. These include safes, locks, keys, etc. Documentary 'recording of purchase customer orders, sales transactions and in fact the entire accounting documents serve as documentary control measures.

Types **of** Fraud

The circumstances in which fraud may be perpetuated are different and appear to be increasing in nature and complexity. Fraud can be external or internal. Internal fraud refers to fraud perpetuated by employees of the organisation. Such members of staff take advantage of their positions of trust to defraud their organizations. This is what is referred to as occupational fraud or white collar crimes.

The other nature of fraud is perpetuated by an individual who is an outsider to the firm. Most of these types of fraud are industry - specific. They are new to the country. These nature of fraud include telecommunication fraud, access device fraud, health care insurance fraud, public program fraud, etc.

**Occupational Fraud and Abuse**

Frauds that fail into this category can be further sub-divided into three branches thus: (i) Corruption (ii) Misappropriation (iii) Fraudulent statements

**1. Corruption**

Corruption rears its head in the work place in up to four ways:

Conflicts of interest - purchases schemes, sales schemes and others.

Bribery - invoice kick-backs, bid rigging which manifests in building projects, sponsoring of overseas trips, payment of school fees to wards.

Illegal gratuities.

Extortion.

**2.Misappropriation**

Asset misappropriation constitutes the most varied of all occupational fraud and abuse. This consists of outright theft, diversion or conversion of company assets. It may include other forms of ingenious contravention by which company employees including management, may desire to deprive the company of Its assets, physical or liquid.

Asset misappropriation is of two types, namely:

(i) Cash (ii) Inventory of all other assets.

**Cash**

Misappropriation of cash may consist of larceny, skimming and fraudulent disbursement:

(a) Larceny may be of cash in hand or from deposit.

(b) Skimming is further sub-divided into three, namely:

- Sales may be unrecorded or understated;
- Receivables may be write-off schemes, lapping schemes or unconcealed schemes;
- Fraudulent disbursement which can take different forms;

Billing schemes: ghost employees, commission schemes, workers compensation, falsified wages.

Expense reimbursement: mischaracterized expenses, over-stated expenses, fictitious expenses, multiple reimbursements.

Cheque tampering - forged endorsement, altered payee, concealed cheques, etc.

Register disbursements — false voids, false refunds, etc.

**(ii) Inventory of AH Other Assets**

This occurs as misuse or larceny. Misuse is an outright abuse of asset in a way that causes it to waste rapidly. The usual intention is to get a replacement. Larceny here may occur in the form of asset requisition, false sales and shipping, purchasing and receiving, unconcealed larceny.

**(iii) Fraudulent Statements**

Fraudulent statements may be financial or non-financial, fraudulent financial statements can be grouped into two:

Asset/revenue overstatement, and

Asset/Revenue understatement.

Asset/Revenue overstatement may be perpetuated in five different ways:

Timing differences.

Fictitious revenue recognition.

Concealed liabilities and expenses.

Improper disclosures.

Improper asset valuation.

On the other hand, fraudulent non-financial statements may be perpetuated in three different ways:

Employee credentials.
Internal documents.
External documents.

**Combating Fraud**

A combination of triune methods of prevention, detection and deterrence help in combating fraud. All these tripartite approaches are targeted at disabling the fraud triangle, which is the foundation of every fraud. Prevention and deterrence aim at: Reducing the supply of motivated offenders.

1. Limiting opportunities by making the crime more difficult to commit.
2. Protecting and educating suitable targets.

Detection of fraud comes in when prevention and deterrence methods fail and the crime is committed.

**Detecting Fraud**

The key to detecting fraud lies in financial managers, controllers and internal auditors. They should always be alert to 'red flags' - signs of wrongdoing and be ready to deal with it, if and when it happens, Auditors should approach audit with conservative scepticism when trying to detect fraud. The underlying question that the internal auditor should look at is "Does this transaction make commercial sense? There are several key criteria to look for.

The first thing to look for is any unusual or non-receiving journal entries. These include unusual adjustments to journals, excessive expenses and purchases and missing documentation. A prudent accountant would then seek to find out why such an unusual entry came about. Was it an error or an intentional mistake? Another area to look at is overtime. Is it the same members of staff that are working overtime? Accountants need to determine whether the overtime worked is reasonable for the project the employee is working on. How about the screening procedures? Are new hires thoroughly screened before they are taken on? Is any background information researched on potential vendors and suppliers of the company before signing contracts?

**Fraud Control Strategy**

Different kinds of frauds require different responses. The key to fraud prevention on the part of the organisation is the development and continuous refinement of an effective fraud control system. The foundation of such a system, is a management philosophy which is sensitive to fraud risk. A strong zero tolerance culture must be created/evolved. It entails disabling the identified fraud triangle through appropriate management proactive efforts at policy, leadership by example, continuous training and implementing Whistle - blowing programmes. The basic elements of such n system fire careful recruitment of staff, a culture of integrity in business and loss prevention within the organisation. There should also be regular auditing of transactions by internal controllers, backed up by independent and accountable external auditors. Dana (2001, p.3) says the first step of defence against complex corporate fraud is to ensure the greatest possible transparency of corporate transactions.

**Corporate Governance**

It is now widely accepted that effective fraud prevention strategies must, in the first instance be generated from upper-level management. **If Chief Executive** Officers and Managers at all levels have a commitment to fraud prevention and also understand how this will be achieved, this will provide the foundation for other employees to support the notion of fraud control.

This is particularly important because research has shown that most frauds, particularly those that ruin organisations, are master-minded by Chief Executives/Managers who override internal controls to make purchases for personal use, misuse expense accounts or misappropriate funds, Across the globe, the largest corporate frauds have been characterised by Chief Executive Officers (CEO's) and/or the Chief Finance Officer who exercised unfettered power, and boards of directors either acting in complicity or are unwilling to challenge such power. This state of affairs makes the establishment of effective codes, of practice and the creation of an ethical environment in the workplace difficult to achieve as such initiatives may challenge directly those in charge of the company who may themselves be the offenders.

Today, global best practice in corporate governance require a degree of independence on the boards of directors and the existence of an audit committee with both internal and external members of the board. Such a Committee is charged with the responsibility of the selection of independent auditors for the company, and the review in collaboration with the external auditors, planning and results of the audit engagement.

## Conclusion

In order to combat fraud, companies should put in place good reporting program. Any reported case of fraud should be vigorously investigated. There must be a sincere commitment on the part of management to eradicate fraud.

A company that has in place an Employee Assistance Program (EAP) which provides employees with an opportunity to deal with personal pressures will experience low incidence of frauds. EAPs help employees deal with problems such as alcohol and drug abuse, gambling, money management and debt, family and personal problems.

Furthermore, having a good medical coverage and counselling seminar help employees cope with personal pressures. Cooperate Society (Credit Unit) in the work place helps to propagate the savings culture which enables workers make it in lean times.

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