FRAUD DETECTION AND PREVENTION: THE CASE OF PENSION ACCOUNTS

Francis Ojaide

Abstract

There have been several complainants by pensioners and non-pensioners about the irregularities and delays in the payment of pensions. Some have argued that the delays in the payment of pensions are due to the inadequacy in the provision of funds to pay pensioners. Others have argued that the issue is not only in the inadequate provision of funds to pay pensioners but also the irregularities perpetrated by those responsible for processing and disbursing pension entitlements. The primary objectives of this paper are to consider the likely areas where irregularities can be perpetrated in the processing and disbursement of pension entitlements and to create awareness of how these areas can be addressed by organizations that have internal audit departments. This paper is subdivided into seven sections. The introductory section encapsulates the issues of fraud. The second section is the definition and types of pension. The third section gives an insight into the laws regulating pension entitlements in Nigeria. The fourth section considers the areas of fraudulent activities in the processing and disbursement of pension funds. The fifth section emphasizes the role of management in fraudulent activities. The sixth section proffers appropriate strategies to be adopted by internal auditors in combating or minimizing the irregularities perpetrated in the processing and disbursement of pension funds The ..seventh section is the recommendations and conclusion of the paper.

Introduction

Frauds are acts of dishonesty, deceit, falsifications and manipulations perpetrated to gain undue monetary and/or non-monetary benefits, fraudulent practices include frauds and all other illegal means of acquiring and possessing an asset to the disadvantage of another person. In accounting, frauds and fraudulent practices arc illegal acts involving misappropriation of assets (cash, stocks, book debts, and fixed assets), manipulation and falsification of accounting books and records, etc. The get-rich quick attitude of many Nigerians, greed, poverty and the falling standards of living are some of the reasons for the increase in the rate of frauds and fraudulent practices in Nigeria, of which pension funds are no exception.

The rate of fraudulent activities in the processing and disbursement of pension is alarming and is seriously affecting the regularity of payment of pensions to pensioners. Due to the controversies associated with the irregularity in the payment of pensions or the non-payment of pension to beneficiaries, government has of recent, enacted a new Pension Law (Pension Reform Act 2004), to address the issue of inadequacy of funds to pay retirees at the point of departure and subsequently during retirement. The subsequent subsections will deal with the definition and types of pension; the laws regulating pension entitlements in Nigeria; the areas of fraudulent activities in the processing and disbursement of pension funds; the role of management in fraudulent activities; appropriate strategies to be adopted by internal auditors in combating or minimizing the irregularities perpetrated in the processing and disbursement of pension funds and some useful recommendations and conclusion of the paper.

Definition and Types of **Pension**

A pension which is also known as superannuation is a retirement plan meant to provide a retired person with a secured income for life (Alexander, 1997; Brown, 2003). The term pension is commonly used to describe the payments a person receives on retirement. It has traditionally been considered as the payments made in the form of a guaranteed annuity to a retired or disabled employee, or to a deceased employee's spouse, children or other beneficiary. Pension plans are a form of deferred compensation. They became popular in the United States during the Second World War when wage freezes prohibited outright increases in workers' pay. Pension plans can be broadly categorized into two. They are the defined contribution plan and the defined benefit plan. In the 1980s, the defined benefit plan had been the most popular and common type of pension plan in the I 'nitcd States. But, thereafter, the defined contribution plan has become the more common type of retirement plan in the United States. In the 1990s, there has been a hybrid of pension plans combining the characteristics of the defined benefit plan and defined contribution plan (Petersen, 1994; Ambachtsheer, 2003).

The defined contribution plan is a form of savings account instituted by an employer for its employees. The employer makes contribution to the fund but all the risks associated with the performance of the pension funds investment is borne by the employee. It is called defined contribution because the only obligation of the employer is to make the stipulated contributions to the employee's retirement account. The employee is responsible for giving directives as to the management of the assets by identifying and selecting where the investment funds should be placed. Investment earnings in this retirement plan are not subject to taxation until the funds are withdrawn and this is usually after retirement (Black, 19S0; Tepper, 1981).

In the case of defined benefit plan, the employer is under obligation to provide a specified annual retirement benefit. The annual retirement benefit is defined by a formula that takes into consideration the years of service and salary grade of the employee. For example, where an employer pays a retired employee a yearly amount equal to 2% of the employee's final annual salary for each year of service, it then means that an employee who serves for 35 years will receive an annual benefit equal to 70% of his final salary. The employer is obliged to make the payments. The assets in the pension fund are collateral for the promised benefits. The employer is under obligation to make up for the shortfall if the investment performance of the assets is poor by contributing additional assets to the fund. The risk associated with investment performance of defined benefit plan is borne by the employer. In Nigeria, there is a new Pension Act known as the Pension Reform Act 2004. The much heralded news about the instrument is that, it will ensure that every person who works in either the public or private sector of the Nigerian economy receives his retirement benefits as and when due, and assists improvident individuals by ensuring that they have enough to cater for a comfortable livelihood during old age.

Laws Regulating Pension Entitlements in Nigeria

The exclusive power to legislate on matters concerning pensions and gratuity in Nigeria rests. with the Federal Government. In 1979, the Federal Government had to enact Decree No. 102 of 1979, (now Act) to consolidate all previous enactments on pensions and gratuity and to also incorporate the pensions and gratuity scales fashioned out for public officers by the Udoji Public Service Review Commission of 1974. This Act, prior to the new Pension Act 2004, was the main source where other pension laws were developed for use in the public service of Nigeria. The other pension laws that had been enacted to cater for certain professional groups include the Armed Forces Pensions Decree No. 103 of 1979; the Pensions Rights of Judges Decree No. 5 of 1985; the Amendment Decrees No. 51 of 1988, No. 29 of 1991, No. 62 of 1991 and No. 11 of 1993.

The old pension schemes in the civil service was non-funded and non-contributory. Governments bore 100 per cent of pension liabilities which were to be a charge against the Consolidated Revenue Fund. Up to the 31st of March, 1976 the Federal Government was responsible for the payment of pension to all officers for the services they rendered to the State Governments, Local Governments and Voluntary Agency Teaching Service. The State Governments paid the retirees and claimed reimbursements from the Federal Government. In consonance with the policy of ensuring that a retiree maintains a standard of living close to his status while in service, the Federal Government has continuously been evaluating the benefit structure in the public service. One of the ways to maintain this standard of living is to adjust pensions to reflect the corresponding increases and upward adjustments in the emoluments of active officers.

Areas of Fraudulent Activities in the Processing and Disbursement of Pensions

Prior to the Pension Reform Act 2004, the mam areas of the Decree No. 102 of 1979. where fraudulent activities could take place in the processing and disbursement of pension funds include the following:

(1) Eligibility to receive **retirement** benefits - The Decree provides that only employees who are on permanent and pensionable appointments are eligible to receive retirement benefits if they retire on pensionable circumstances. It excludes persons under the age of 15 years from being employed on permanent and pensionable terms in the public service. However, the law disallows any person over 45 years of age from being employed on permanent and pensionable conditions.

(ii) Circumstances for granting pension and gratuity The circumstances under which pension and gratuity may be granted are contained in Sections 3(1) (2) of Decree No. 102 of 1979. They include voluntary retirement or withdrawal after qualifying service; the attainment of the maximum statutory age of 60 years or 35 years length of service, whichever is earlier; the compulsory retirement from service for the sake of greater efficiency or economy in the reorganization of the person's department or ministry; on medical grounds, that is, the person being incapable either mentally or physically to carry out his official responsibilities; total or permanent disablement while in service; the abolition of the person's office as in Section 7 of the Decree No. 2 of 1979, and compulsory retirement in the public interest. It is important to note that any officer who is compulsorily retired on the above basis is entitled to his pension immediately on retirement notwithstanding whether he has attained 45 years of age or not.

(iii) ApproximatiofTof **length** of service - The approximation of a period of service of over 6 months to be considered as one year is only applicable to officers who qualify for pension and have attained the qualifying period of 10 years.

(iv) **Qualifying** service - The qualifying period for pension and gratuity under Decree No. 102 of 1979, is 10 years for gratuity and 15 years for pension, [kit Circular No. B. 632 I 6.S. 1/X/7/S or22'Hl July, 1992 has made officers to qualify for gratuity on attaining 5years of service and 10 years of service for pension.

(v) Statutory age of retirement - The statutory age of retirement in the public service contained in Section 4(1) of Decree No. 102 of 1979 is 60 years. Bui, under special dispensation, judicial officers and academic staff of universities are to retire at 65 years. However, the Civil Service (Reorganization) Decree No. 43 of 1988 adds that officers should retire on attaining 60years or 35 years of service, whichever is earlier. Though, this Decree has been abrogated, the two conditions still remain in force by the Secretary to the Government of the Federation Circular No. 58341/S.11/T.3/146 of 6th July, 1995 and the Federal Civil Service Commission Circular No. FC. 6214/T.2/4 of 14th September, 1995. By virtue of the provisions of Decree No. 11 of 1993, Government gave a special dispensation to academic staff of Federal Universities to retire at age 65 with the abrogation of 35 years of service. It is important to note that presently, this dispensation has not been extended to non-academic staff of universities nor the academic and non-academic staff of Polytechnics and Colleges of Education. The onus is on the retiring officer to give six months notice of his/her intention to retire from the service. According to Establishment Circular No. B 63216/S.1/X/539 of 22nd February, 1989 any officer who stays beyond the date he is expected to retire shall have all his emoluments earned by him, thereafter, deducted from his retirement benefits, (vi) Pension **and** Gratuity when an Officer dies in Service Section 5 of the Decree limits the pension payable to the representative of an officer who dies in service lo 5 years after completing the minimum period of qualifying service at the date of death. Bui where he dies before completing the qualifying period of service, the personal representative of the deceased officer will be entitled to only one year salary.

(vii) **Withdrawal from** Service - Section 21(1) of the Decree states that an officer who has served for 10 years or more in a pensionable post and wants to retire should give 3 months notice of his intention to retire or pay three months salary in lieu of notice. Where an officer wants to withdraw from service after serving for less than 10 years but more than 5 years, he is required to give one month notice of his intention to withdraw his service or pay one month salary in lieu of notice, (viii) **Maximum and Minimum Pension** - Section 22 of the Decree states that an officer who serves a maximum period of 35 years is entitled to a maximum pension of 70 per cent of his final salary (see **Table A).** However, the maximum pension has been increased to 80 per cent since the lst of June, 1992. The Decree No. 102 of 1979 specifies a minimum pension of N360.00 per annum. This amount has been reviewed upward several times, and in Circular No. B.63216/S. l/X/710 of 20th December, 1994, the minimum amount was increased to N7. 996.80 per annum. The effective date of the Circular was lst of October, 1994. '.

(ix) Calculation of Retirement Benefits

By the Circular No. B.63216/S. l/X/6 I 8 of 13"' September, 1991, the Federal Government reviewed pension rates. In the Circular, it is stated that the calculation and payment of retirement benefits should be based on the terminal total annual emolument of an officer. The component units of an officers' total emolument for the purpose of the calculation of retirement benefits for the different salary grades are stated below:

- Officers on salary grade level 01 to 09 - the calculation includes annual terminal basic salary, annual transport allowance and annual rent subsidy.
- Officers on salary grade level 10 to 15 the calculation includes annual terminal basic salary, annual transport allowance, annual rent subsidy and annual meal subsidy.
- Officers on salary grade 16 the calculation includes annual terminal basic salary, annual transport allowance, annual rent subsidy and annual entertainment allowance.

Table A: Old Schedule for the Computation of Retirement Benefits

Years of Qualifying Service	Gratuity as % of Final Pay	Pension as % of Final Pay
1 9	Nil	Nil
10	100	Nil
11	110	Nil
12	120	Nil
13	130	Nil
14	140	Nil
15	100	30
16	110	32
17	120	34
18	130	36
19	140	38
20	150	40
21	160	42
22	170	44
23	180	46
24	190	48
25	200	50
26	210	52
27	220	54
28	230	56
29	240	58
30	250	60
31	260	62
32	270	64
33	280	66
34	290	68
35	300	70

Source: Pension Reform Act 2004, First Schedule, Section 8(3)

- Officers on salary grade 1 7 and above - the calculation includes annual terminal basic salary, annual transport allowance, annual rent subsidy, annual entertainment allowance and annual salary of entitled domestic staff but not exceeding two domestic staff for grade level 17 officers and four for officers on consolidated salaries occupying pensionable posts.

The allowance for utility services was later added to the list of fringe benefits to be taken into consideration in the computation of retirement benefits. The effective date for the implementation of the circular was l[sl] of January. 1991. Subsequently, Circular No. B.63210/S.1/X/7/8 of 22[,RI] July, 1992 reviewed the qualifying service for both pensions and gratuity. It increased the maximum rate of pension for 35 years of qualifying service from 70 per cent to 80 per cent **(see Table B).**

Table B: New Schedule for the Computation of Retirement Benefits

Years of Qualifying Service	Gratuity as % of Total Final Emolument	Tension as % of Total Final Emolument
1 -4	Nil	Nil
5	100	Nil
6	108	Nil
7	1 16	Nil
8	124	Nil
9	132	Nil
10	100	30
11	108	32
12	116	34
13	124	36
14	132	38
15	140	40
16	148	42
17	156	44
18	164	46
19	172	48
20	180	50
21	188	52
22	196	54
23	204	56
24	212	58
25	220	60
26	228	62
27	236	64
28	244	66
29	252	68
30	260	70
31	■268	72
32	276	74
33	284	76
34	292	78
35	300	80

Source: Pension Reform Act 2004, First Schedule, Section 8(3)

The qualifying period of service for gratuity was reduced from lOyears to 5 years and that of pension from 15years to 10 years. The new schedule for the computation of retirement benefits took effect from lst June, 1992. The new benefit structure was made applicable to pensioners on the payroll before Ist June, r992. A ID per cent increase was applied across the board. Then, with the 45 per cent interim salary increase for public officers contained in Circular CND. 26/S.5/C/Vol. IV/220 of September, 1992, the Federal Government approved that the pension of all retirees on the payroll as at 31st May, 1992 should be increased by 45 per cent across the board. The implementation took effect from Ist June, 1992. Circular No. B. 63216/S.1/X/710 of 20th December, 1994 increased minimum pension to N7, 996.80 per annum. The Circular was issued as a result of the increase in the rate of transport allowance and rent subsidy paid to Federal Civil Servants and staff of Federal parastatals. The effective date of the circular was 1st October, 1994.

The Role of Management in Fraudulent Activities

It is the primary responsibility of management to detect and prevent frauds and fraudulent practices in an organization (Gendron, 2002; Wells, 2004). This is done by instituting all necessary control measures such as internal control and checks within the organization. Management can also enhance the operational efficiency of internal control and checks by establishing an internal audit department. The role of an internal auditor in this respect is to assist management in ensuring that the system of accounting, internal control and checks are operating effectively and efficiently (Knapp and Knapp, 2001; Arens, Elder and Beasley, 2005).

Section 283 (1) of the Companies and Allied Matters Decree 1990, states:

> Directors are trustees of the company's moneys, properties and powers and as such must account for all the moneys over which they excise control and shall exercise their powers honestly in the interest of the company and all the shareholders and not in their own sectional interests.

This statutory responsibility on the pari of the management is quite enormous and includes llie custody and safety of assets and the efficient management of the organization in ils entirety. 1 iowever, in the course of an auditor's work, he may come across a situation which arouses suspicions ami may require further investigation of the existence of frauds. The detection and prevention of frauds are not the primary responsibilities of an external auditor but of management. The primary responsibility of an external auditor is to express opinion on the financial statements presented to shareholders/board members as to whether they show a true and fair view and comply with statutory requirements (Braun, 2000). Frauds are easily perpetrated in the areas of cash, sales, purchases, wages and payroll, stocks of finished goods and raw materials. Frauds may be perpetrated in both manual and computerized accounting system. The frauds that are perpetrated by the use of computers are known as computer frauds. Accounting system frauds occur through improper postings to a ledger account; dubious calculations; improper book entry and/or suppression of a book entry.

In a computerized accounting system, frauds can be perpetrated through Input Manipulation -this is a situation where input data are intentionally manipulated. For example, where a customer's cheque is posted to expense account instead of the customer's personal account; amending the content of input data forms after they have been approved; or forging the authorization of the input data forms. Programme Alteration - where the original programme is altered without authorization. File Alteration - where the content of a file is altered without authorization. Frauds and fraudulent practices exist in systems in which internal control and internal checks are weak (Champlain, 2003; Buckless, Ingraham and Jenkins, 2004). Efficient and effective internal control and internal checks make it difficult for the perpetration of frauds. However, there are also cases where frauds can be perpetrated even where the system of internal control and internal checks are adequate. Such cases would involve the collusion between two or more staff and the exercise of undue powers by management. These two areas are quite difficult to detect and handle because those entrusted with the powers to take care of the procedures are those committing the frauds and fraudulent acts. Fraud through collusion can be reduced through regular rotation of staff and compelling staff to go on contractual leave. The frauds committed by management are easily blown out when there is a commission of enquiry,; probe or removal/transfer of the management staff or the entire management.

The specific areas of fraudulent activities in pension accounts include the following:

- Including ghost pensioners on the payroll and pocketing their pay;
- Overcastting of gross pay and net columns in payroll and emolument sheets and stealing the difference resulting from overcastting;
- Making statutory deductions from the pensioners' pay and refusing to pay them over to the relevant authority;
- Including pensioners' names two or more times on the payroll;
- Misappropriating the unclaimed pensions of pensioners;
- Collecting contributions for a staff pension fund and failing to invest the money;
- and conniving with pensioners to inflate their entitlements for selfish interest. Fraudulent acts can also be perpetrated by falsification of date of birth; date of first

appointment; statement of indebtedness; final pension emolument; pension calculation: gratuity calculation; re-computation on promotion/upgrading; re-computation on demotion; existing name in record of service; current rank; period of service; and effective date of pension.

Appropriate Strategies to be Adopted by Internal Auditors

Apart from the normal audit procedures, detection and prevention will involve the following:

- Checking the original document from which salaries sheets of pensioners are compiled. This will involve checking the changes in pension rates and the original letter of notification of retirement or withdrawal of service.
- Regular checks on the pensioners' payroll to ensure that only those on retirements are actually reflected.
- Casts and cross-casts should be checked and pensioners' control accounts or register should be updated.
- Unclaimed pensions should be monitored and banked.
- The system of internal checks should be investigated to find out whether it is operating well and any loopholes noted should be rectified.
- Payment records should be checked against cheque stubs and original payment source documents.
- Signatures signifying authorization of payment should be cross-checked

The following steps are necessary to prevent computer frauds: -

- Restricting access to computer facilities to only authorized persons.
- Locking the computer rooms and the computers.
- Using passwords
- Verifying the validity of computer programme
- Controlling computer input data

In reporting frauds and irregularities, particular attention should be paid to the purpose of report; basic documents examined and information obtained; and proper cross referencing of the copies of documents attached; outline of the work carried out; highlights/summary of information obtained as a basis for the recommendations; and the recommendations should be clear and unambiguous. All these steps are necessary to combat or minimize the irregularities perpetuated in the processing and disbursement of pension.

Recommendations

Based on the issues raised in the paper, the following recommendations will be useful to audit practitioners, scholars, pension desk officers and management:

1. Pension funds deducted from payrolls should be regularly invested in instruments that will earn reasonable returns on investments.
2. Regular payments should be made to pensioners to enable them meet their basic necessities of life. Situations where pensioners arc owed several months of salary should be avoided to. allay fears of prospective pensioners.
3. There should be regular staff training for pension desk officers and administrators to keep them abreast with current developments relating to pension matters.
4. Management should ensure that prospective pensioners are given adequate training that will assist them to process their retirement papers properly to avoid mistakes that usually cause delays in the payments of pension to retirees at the point of departure and on how to live a happy and meaningful live after retirement.
5. Management should ensure that proper internal control and checks are put in place in their organizations to act as deterrent to the perpetrators of fraudulent activities in pension funds processing and disbursements.
6. Internal auditors should assist Management by ensuring that internal control and checks in the organization are functioning well through regular routine checks in the departments and units responsible for the processing and disbursement of pension funds.
7. Strict penalty and sanction should be enforced to ensure that employers and pension administrators do not divert pension funds to solve their immediate and pressing liquidity problems at the expense of pensioners.

Conclusion

This paper has identified the areas of fraudulent activities in the processing and disbursement of pension funds and the role of management in detecting and preventing fraudulent activities within an organization. It has also proffered appropriate strategies to be adopted by internal auditors in combating or minimizing the irregularities perpetrated in the processing and disbursement of pension funds. In conclusion, it is the responsibility of management to ensure that there are no irregularities in the processing and disbursement of pension funds and that pensioners are paid their entitlements as and when due.

References

Alexander, Stephen Joseph. (1997). Pension Funds and Economically Targeted Investments: Alternative Investment Resource for Inner City Revitalization. Chicago: University of Illinois.

Ambachtsheer, Keith. (2003, Wednesday, July 16). The Real Pension Crisis. The Financial Post. P.FP15.

Black, Fisher. (1980). The Tax Consequences of Long Run Pension Policy. *Financial Analyst Journal* 36 (July-August), 1980, pp. 21 - 28.

Braun, R.L. (2000). The Effect of Time Pressure on Auditor Attention to Qualitative Aspects of Misstatements Indicative of Potential Fraudulent Financial Reporting. Accounting, Organizations and Society, 25(3), PP. 243 - 259.

Brown, Larry. (2003). Investing in a Better World? The Union in Joint Trusteeship of Pension Plans. In Carmichael, Isla and Quarter, Jack (eds.) Money on the Line: Workers' Capital in Canada (pp. 7 - 14). Ottawa: Canada Center for Policy Alternatives.

Buckless. F.A., L.R. Ingraham and J.G. Jenkins. (2004). Comprehensive Assurance and Systems Tool: An Integrated Practice Set. New York: Prentice Hall.

Champlain, J.J. (2003). Auditing Information Systems. New York: John Wiley and Sons.

< iendron, Y. (2002). On the Role of the Organization in Auditors' Client-Acceptance Decisions. Accounting, Organization and Society, 27(7), pp. 659 - 684.

Petersen, Mitchell A. (1994). Cash Flow Variability land Firm's Pension Choice: A Role for Operating Leverage. Journal of Financial Economics, 36, December, pp. 361 383.

Wells, J.T. (2004). Corporate Fraud Handbook: Prevention and Detection. New York: John Wiley and Sons.