**AN ASSESMENT OF EFFECTIVENESS OF INTERNAL CONTROL IN DETECTIONS AND PREVENTIONS OF FRAUD**

**CASE STUDY; ELCT –ELVD**

**CHAPTER ONE**

* 1. INTRODUCTION

Internal control is defined as a process affected by organization’s structure, work and authority flows, people and management information systems, designed to help the organization accomplish specific goals or objectives (AICPA, 2003). Internal control systems are not new to the Government and private sector organizations. There are checks and balances already in place which have been part of normal day to day working of the Government Ministries and Departments. In both sectors, accountability is of prime importance.

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**1.0 Introduction**

Background of the study provides a description of the basic facts and importance of research area.

**1.1 Background of the study**

Internal controls are the mechanisms, rules, and procedures implemented by a company to ensure the integrity of financial and accounting information, promote accountability and prevent fraud. Besides complying with laws and regulations, and preventing employees from stealing assets or committing fraud, internal controls can help improve operational efficiency by improving the accuracy and timeliness of financial reporting (Karagiorgos, Drogalas, and Dimou 2011).

The primary purpose of internal controls is to help safeguard an organization and further its objectives. Internal controls function to minimize risks and protect assets, ensure accuracy of records, promote operational efficiency, and encourage adherence to policies, rules, regulations, and laws (Guide 2019).

Fraud, on the other hand is defined by Anyway (1993) as an act of deception deliberately practiced to gain unlawful or unfair advantage to the detriment of another. The international standard on Auditing (ISA) defines fraud as an intentional act by one or more individuals among management, those charged with governance, employees or third parties involving the use of deception to obtain an unjust or illegal advantage. Fraud may include manipulation, falsification or alteration of documents and records; recording transaction without substances and intentional misapplication of accounting policies(Public et al. 2013).

**1.3 Research Questions**

* To what extent internal control help in detection and prevention fraud?
* Does organization activity affect the effectiveness of internal control in detection and prevention fraud?
* What are the challenges occur in detection and prevention of fraud?
* Does the Internal Control System have impact on the overall management of organization?

**1.4 Objectives of the study**

**1.4.1 General objective**

The main objective of this study is to assess the effectiveness of internal control in detection and prevention fraud

**1.4.1 Specific objective**

* To make sure every transaction gets systematically recorded in a sequential basis.
* To grant enough security to the assets of the company from preventing it to be used in an unauthorized manner.
* To make sure optimum utilization of resources is taking place within the firm.

**1.5 Significance of the Study**

Establishment of an adequate Internal Control and its effective review and assessment by the management will go a long way in preventing fraudulent acts and practices among the fraudsters within the organization and other third parties. The usefulness and the expected benefit of the study are entail the following.

* It will help in knowing and studying how the principles of Internal Control Components or elements are used to prevent fraud.
* It will also result in reduction in an attempt to defraud by the management and staff as a result of lay-down expected punishment.
* It will also enhance accurate operation of organization activity as a result of strong internal control being put in place.
  1. **PROBLEM STATEMENT**

Internal control are the policies and procedures used in an organization to guide day to day operations, for smooth operation of the organization there must be transparency, accountability and integrity. Having an effective internal control system can strengthen the process, structure and value of the organization (Zakaria,2016).

The regularity of fraud and misappropriation of funds is creating fear, anxiety, and a loss of confidence in the minds of owner of organization. Also, poor internal control system leads to increase of asset losses. Management is required to set up an internal control system but this system varies significantly from one organization to the next, depending on such factors as their size, nature of operations, and objectives (Deloitte 2014).

Most of the system for fraud detections and prevention need to be updated, organization and financial institutions have been losing a lot money because of weak internal control system, despite the rapid growth of technological skills, less has been adopted to detect and prevent fraud.

ELCT-ELVD just like other organization has policies and procedures that guides day to day operation, and an assessment of effectiveness of internal control system is the pillar for its growth, researcher will investigate the extent which internal control detect and prevent fraud.

* 1. RESEARCH OBJECTIVE

**General objective**

* To investigate effectiveness of internal controls in detection and prevention of fraud

**Specific Objectives**

* To identify operation of ELCT- ELVD internal control system
* To determine mechanism for fraud detection
* To assess fraud prevention mechanism
* To grant enough security to the assets of the organization from preventing it to be used in an unauthorized manner.
* To make sure every transaction gets systematically recorded in a sequential basis
  1. **Research Questions**
* How does the internal control system operate in ELCT-ELVD
* To what extent internal control help in detection and prevention of fraud?
* What are the challenges facing detection and prevention of fraud mechanism?
* Does the Internal Control System have an impact on the overall management of organization
* Does organization activity affect the effectiveness of internal control in detection and prevention of fraud?

**CHAPTER TWO**

# **LITERATURE REVIEW**

## **1.0 Introduction**

This section intends to discuss the conceptual and theoretical literature works that have been conducted relating to the effectiveness of internal control in detection and prevention of fraud.

* 1. **Theoretical Review**

This section will discuss the theory relating to internal controls such as fraud triangle theory and fraud diamond theory, which are important key theories regarding the internal controls.

**1.1.1 Internal Control**

Internal control is defined as a process affected by organization’s structure, work and authority flows, people and management information systems, designed to help the organization accomplice specific goals or objectives (AICPA, 2003). Internal control systems are not new to the Government and private sector organizations. There are checks and balances already in place which have been part of normal day to day working of the Government Ministries and Departments. In both sectors, accountability is of prime importance. (COSO, 2011).Most of the internationally accepted standards and best practices in internal control has classified internal controls into five components namely:

**1.1.2 The Fraud Triangle Theory (FTT)**

Donald Cressey, (1950), focused his study on what drives persons to interrupt expectation. He questioned 250 offenders in five months whose conduct met two principles; primarily, individuals are accepting accountabilities of faith in good faith, and secondly situations make them breach the reliance. He noted that 3 aspects pressure, opportunity, as well as justification should be present for persons to breach their place of belief. The three basics of scam were shortened by Cressey (1953) as follows.

**1.1.2.1 Perceived Pressure/Incentive/Motive**

Any fraudulent behavior begins with gravity to cause fraud (Abdullahi and Mansor, 2015a). The pressure can be non-monetary or monetary. Fraud begins with the perpetrator believe that he or she is pressurized. Pressure exists in a number of ways, particularly in a non-sharable monetary requisite. Monetary force is commonly the factor forming basis of an organization to commit fraud. Vona, (2008) posits that about 95% of all fraud cases are related to perpetrator’s financial pressure. Pressure therefore is an important factor in perpetration of fraud (Lister, 2007). He further determined three types of pressure which include stress due to employment, personal and pressure from external environment. Vona, (2008) examined corporate and personal forces as key motivation for fraud to be committed. Examples of pressure include addiction to drug, financial challenges related to family, huge debts as well as expenses.

**1.1.2.2 Observed Opportunity**

Opportunity is produced by weak controls or poor authority structure that permits a worker to commit employee scam. It is referred to as weaknesses in internal controls. Opportunity will exist in the awareness of the culprit. Mostly, the low the probabilities of being found, the more the likelihood of fraud occurring. Cressey, (1953) defines opportunity being the capability to supersede given scam controls. Opportunity is the power and ability of a worker to establish week institutional systems of control and capitalize on committing fraud (Rae and Subramanian 2008).

**1.1.2.3 Rationalization.**

For fraud to occur, the perpetrator formulates unacceptable idea to him before committing fraud. The person carrying out the scam frequently justifies the scam. Justifications may comprise, “I will remunerate the cash back”, “They will not miss the moneys”, or “They do not pay me sufficient.” The fraudsters must have a specific mind-set that allow them to rationalize their behavior before committing crime.

**1.1.3 The Fraud Diamond Philosophy**

Dunn, (2004), claimed that though apparent pressure may exist with prospect as well as a justification, it is improbable for scam to happen except if the fourth component (ability) also exists, that known as fraud diamond philosophy. It explain that for fraud to occur four components which are capability, incentive, rationalize, and opportunity must also exist

**1.2 Empirical Literature Review**

Beasley, (1996) conducted study relating to effectiveness of internal control in detection and prevention of fraud, the study shown that incentives, pressure and rationalization forces fraudsters to focus on weaknesses within the internal controls that could permit them to commit fraud.

Inconsistent results have been found in relation to internal controls existence and the likelihood of fraud (Beasley, 1996; McMullen, 1960; Dechow et al., 1996). However, internal control system effectiveness has been found to reduce the likelihood that companies are sanctioned for fraudulent financial reporting (Abbott et al., 2000). A positive relation was found between concentration of power in the hands of insiders and the likelihood of issuing fraudulent financial statements (Dunn, 2004). In South Africa, a negative relation has been found between the proportion of independent directors and institutional investors and the likelihood of fraud, while a positive relation was found between duality (chair of board and also the chief executive officer) and the likelihood of fraud, (Sharma, 2004). One difference from this study to others was that in his measure of fraud (Sharma, 2004) used both financial statement fraud and misappropriation of assets. Analysts suggest that with sufficient pressure, incentive and rationalization, the perpetrators often turn their attention towards the opportunities that exist within the public financial management system’s internal control structure that could allow for fraud to be committed (Mars Group, 2008).

**CHAPTER THREE**

**RESEARCH METHODOLOGY**

This chapter explains the methodology which will be used in obtaining and analyzing data from the area of study .Research methodology is a systematically way of solving research problems in a certain area” [Kothari 2001; 10]

This chapter includes research design, population and sample, sampling techniques, and methods of data collection and data analysis.

## **Research Design**

A research design will guide the researcher in planning and implementing the study in a way that is likely to achieve the intended goals (Burns & Grove, 2001).

## **Sample size and sampling techniques**

This refers to the number of items to be selected form the universe to constitute a sample. An optimum sample should be one which fulfils the requirements of efficiency, representativeness, reliability, and flexibility as stated by (Kothari, 2006). In this study the researcher will opt for ‘purposive sampling’, where the researcher will select the participants according to the usefulness of data to be generated this adhered in assurance of the credibility of the sample and coverage to the targeted groups.

## **Types of data and sources of data collection**

### **Primary data**

### are the ones collected by a researcher from the field. This data will be collected by the researcher from the field, interview, focus group discussion and questionnaire will be conducted

**Secondary data** are those data which have already been collected by someone else and they have been documented. This type of data obtained from internet, research reports, journals and published and unpublished book

### **Interview**

Kothari (2004), defined; interviews involves presentation of oral-verbal stimuli and reply in terms of oral-verbal responses.

Under this data collection method there is direct contact between researcher and respondents where the researcher is an interviewer and respondent are interviewee so sources of information will be from interviewee. The researcher decided to use interview so as to manage time since it involved asking questions to respondents and replying at the time and getting data accurately because some workers were busy with their works thus why the employed method was acceptable for the situation which decreased the number of non-respondents

**DATA COLLECTION METHODS**

**Interview**

According to (Kothari, 2006), an interview is a set of questions administered through oral or verbal communication or is a face to face discussion between the researcher and the interviewee. Researcher will use interview to gives more room to the interviewers to clarify and elaborate one’s ideas, aspirations, and feelings (Patton, 2002; Long, 2007 &Windbridge et al., 2009). The researcher will employ semi-structured interviews

**Focus group discussion**

Focus Group Discussion method will be conducted in a group of eight to ten participants, researcher will have a checklist to guide the discussion, this method is employed to obtain more qualitative information, and FGD will be conducted in order to get further insights of respondents’ attitudes and opinion on fraud detection and prevention in ELCT- ELVD.

**Questionnaires**

(Kotler 1997) defines questionnaires as a set of questions presented to the respondents for their answers, researcher will prepare both closed ended questionnaire and open ended questionnaire to get detailed information in this study

CONCEPTUAL FRAMEWORK

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**APPENDIX 1: QUESTIONNAIRE**

This questionnaire is designed to collect data investigation of an assessment of effectiveness of internal control in detections and preventions of fraud: Case Study; East of Lake Victoria Diocese (Elct –Elvd) .

PART A: GENERAL INFORMATION

Please Tick Where Appropriate:

1. Gender

a. Male [ ]

b. Female [ ]

1. What is your age group?

a. 20-35 years [ ]

b. 36-51 years [ ]

c. 52 and above [ ]

1. What is the level of the qualification do you have?

a. No qualification [ ]

b. Secondary education certificate [ ]

c. Tertiary qualification in internal auditing and accounting [ ]

d. Other tertiary qualifications [ ]

1. To what extent do you agree with the statement that the internal audit and control mechanism exists in the East of Lake Victoria Diocese (Elct –Elvd).

a. Strongly agree [ ]

b. Agree [ ]

d. Disagree [ ]

e. Strongly disagree [ ]

1. Do you think Internal Controls has the capacity to prevent or detect frauds?

a. Yes [ ]

b. No [ ]

1. Do you understand the nature of Internal Control System at East of Lake Victoria Diocese organization?

a. Yes [ ]

b. No [ ]

1. How often do you prepare reports and other returns to management?

a. Monthly [ ]

b. Quarterly [ ]

c. Half-Yearly [ ]

d. Annually [ ]

1. Do you think the East of Lake Victoria Diocese has future training plan for the internal Auditors in order to upgrade their skills and expertise in the field of auditing?

Yes [ ]

No [ ]

1. Do you think the recommendations made by the internal auditors after conducting of internal audits and controls are being implemented by the top management?

Yes [ ]

No [ ]

1. To what extent do you agree with the statement that the East of Lake Victoria Diocese has well laid out audit plans for managing and control major internal risks identified by internal auditors?

a. Strongly agree [ ]

b. Agree [ ]

c. Neutral [ ]

d. Disagree [ ]

e. Strongly disagree [ ]

1. To what extent do you agree with the statement that the East of Lake Victoria Diocese does not permit internal auditors to audit operations which they have undertaken?

a. Strongly agree [ ]

b. Agree [ ]

c. Neutral [ ]

d. Disagree [ ]

e. Strongly disagree [ ]

1. Is the internal control system involved in ant-fraud prevention efforts?

a. Yes [ ]

b. No [ ]

1. If yes, what level of responsibility does it take?

a. High [ ]

c. Moderate [ ]

d. Low [ ]

1. Can you just list the types of frauds that you know, your organization suffered in the past five years and its frequency?

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