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# Strategies for Fraud Detection, Prevention and Deterrence

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JAFARU JIMOH  
*Accountancy Department  
Auchi Polytechnic, Auchi*

## **Abstract**

*In recent times, there has been growing criticism against the accountants on questionable acts, whether as auditors or managers in industry. Some of the concerns expressed border on turning a blind eye on issues that should have been brought to the attention of the investing public and certifying financial statements, which they believe have not been saying it all. The accounting profession is beginning to change from examination of irregularities to examination of fraud on the part of employees and management. The goal is to responsibly address investors' concerns about the financial reporting system, thereby protecting their shareholder rights. But the question has been asked as to whether the professional bodies are doing enough. The main objectives of this paper are to enhance financial information reliability; and to ensure that the regulatory agencies are effective. The major findings are that law enforcement agencies in Nigeria lack the necessary skills to combat financial fraud. In order to curb the increasing rate of fraudulent practices in our society a management team should be encouraged so as to implement accounting ethics and forensic accounting which is a strong control mechanism. Based on the findings, it was recommended, that the full disclosure of relevant financial information and strict enforcement of code of corporate governance as well as oversight functions by senior management should be ensured. Awareness of accountants about forensic accounting and ethical values should be improved upon through continuing education programmes.*

## **Introduction**

The rate at which fraud is perpetrated in the Nigerian economy is assuming an alarming proportion. It has continued to bring a lot of hardships and pains to this current generation of Nigerians. If appropriate steps are not taken promptly to forestall the sporadic spread of this cankerworm, it may extend to the generation of Nigerians yet unborn. The paper will examine the causes of fraud, the various classification and types of fraud as well as the symptoms/warning signals indicating its existence in an environment. It will also consider ways for fraud detection, prevention and deterrence as well as a conclusion.

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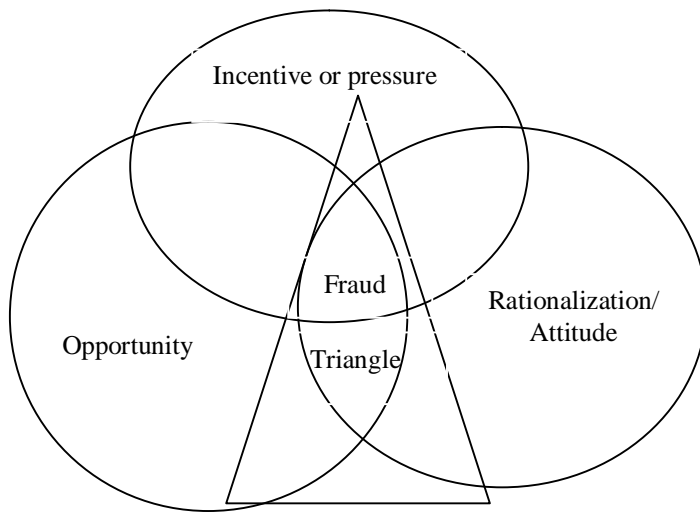
### **a. Causes of Fraud**

In the broad sense, the causes of fraud are summarised in an axiom known as the fraud triangle, developed from the work, of Donald Cressey. The three elements of the fraud triangle are: Pressure or Motive, Opportunity and Rationalization.

Cressey concluded that individuals commit fraud when three factors are present:

- \* A financial need that cannot be shared (Motive)
- \* A perceived opportunity for illicit gains or gain improper access to funds (opportunity).
- \* A personal justification of the act to themselves (Rationalization)

**Figure 1: The Fraud Triangle**



**Source:** Golden, Shalak and Clayton: (2006)

In other words, people commit fraud because they need or think they need the money, they believe they will not be caught; and they have justified the act to themselves. Cressey reportedly asked offenders why they had not committed violations at other times and received three basic replies: “there was no need for it like was this time”; “the idea never entered my head”; and “I thought it was dishonest then, but this time it did not seem dishonest at first”.

### **Accountant’s Perception of the Fraud Triangle**

Accountants perceive that the fraud triangle suggests at least three general ways of preventing fraud:

- \* By altering the motives of individuals,
- \* By limiting the opportunity for secretly gaining access to funds, and
- \* By undermining common rationalizations through general education or interrogation of individuals.

Accountants equally perceive that behaviour is learned and can thus be modified. However, they believe that the best deterrent of all is removing temptation from possible offenders.

As a means of mapping out strategies towards detecting and checking fraudulent practices, it is deemed necessary to attempt to know why fraudulent practices are committed in the first place. Cressey catalogued six types of non-shareable problems that provoke fraud:

- Inability to pay debts
- Problems resulting from personal failure
- Business reversals
- Physical isolation
- Status gaining
- Employer-employee relations.

Also, Management Audit Services Consultants (1999) enumerated the following as reasons of committing fraud.

- Desperate need for money
- Job frustration
- Heavy personal indebtedness
- Everybody-Does-It syndrome (Rationalization of contradictory behaviour)
- Enjoy “Beating the system”
- Internal control is lax (it is easy)
- Low probability of detection
- Low probability of prosecution
- Family or other induced extravagant means of living, Greed
- Low loyalty
- Revenge
- Inadequate hiring practices

The above reasons, no doubt, appear to focus mainly on individual fraudsters even though it is equally a known fact that frauds take place at corporate levels, also. At this level, corporate management in order to conceal losses, secure financial advantages such as loans, attract investors, etc., may adopt fraudulent means. Table 1 is used to show types of fraud and those responsible for committing them.

Added to the fraud dimensions above is the recent phenomenon recognized as computer fraud. This type of fraud is reported to be gradually gaining ground in Nigeria, while it is so pervasive in other parts of the world like the United States where it is reported that a sum of about \$500 million is lost annually through this means, Collins (2000).

**Table 1: Taxonomy of Organizational Fraud**

<b>Fraud by Staff</b>	<b>Fraud by Staff/Outside Collaborators</b>	<b>Fraud by Management</b>	<b>Fraud By Management/Outside Collaborators</b>
Diversion of Imprest sums	Suppressing of documents	Inflation of assets	Operation of illegal bank accounts
Failure to record Receipts	Manipulation of bank accounts	Omission of liabilities	Over invoicing
Diversion of stock and other warehouse items	Faking of documents	Insider credits	Faking of transactions
Forgery	Suppressing of transaction	Payroll fraud	Inflation of contracts
Kiting	Under invoicing	Misuse of IOU's	
Payroll fraud	Omission of transactions	Diversion of official facilities	
Teeming and lading	Fictitious borrowing		

**Source:** Damagum (2003)

Management is responsible for the quality of financial statements and organization's internal control structure. U.S.A. Statement of Auditing Standard (SAS No.1 states that "Management is responsible for adopting sound accounting policies and for establishing and maintaining internal control that will initiate, record, process and report transaction's consistent with management's assertions embodied in the financials statements", Sections 302 and 404 of the Sarbanes Oxley Act of 2002 require certifications by members of management as to the completeness and accuracy of financial reports and the nature and effectiveness of internal controls.

**b. The Reasons why Financial Institutions Engage in Financial Statements Fraud**

1. To encourage investment through the sale of stocks/shares
2. To demonstrate increased earnings per share
3. To dispel negative market perceptions
4. To obtain financing, or to obtain more favourable terms on existing financing.
5. To receive higher purchase prices for acquisitions
6. To demonstrate compliance with financing covenants
7. To meet company goals and objective and
8. To receive performance related bonuses

The reasons stated above may look smart and beneficial to financial institutions but to the investor, this is the height of mean deceit, trickery and cheating from officials and accountants who are trustees in a sense.

**c. Indicators of Financial Statements Fraud**

1. Inadequate leadership at the top
2. Collusion among accounting employees.

3. Aggressive/creative accounting policies. Weak internal controls or lack of internal control and poor corporate governance.
4. Complex and intricate transactions especially those outside the company regular course of business.
5. Executive or senior managers' compensation tied to earnings.
6. Autocratic senior management like in Enron.
7. Weak, inexperienced and illiterate Board of Directors.
8. Lack of or insufficient supporting documentation for journal entries.

Clearly, the consequences of ethical violations in accounting and finance are serious, even terminal in the case of some companies. According to most authorities (Anumaka 2007; Mcdamet, et.al, 1999; Mulford and Comiskey, 2002; Silverston and Sheetz, 2004; and Izedonmi, 2001) the best defence against ethical violation involving financial statement is a management team that is committed to implementing accounting ethics and forensic accounting which is a strong internal control mechanism.

#### **d. Fraud Symptoms/Warnings Signals – The Nigerian Perspective**

There are a lot of symptoms or signals that usually indicate the existence of fraud in an environment. Some symptoms are very clear to see by an ordinary person while others require a skillful training in the areas of fraud detection, prevention and deterrence. In an environment, where the standard of living of a person is beyond his legitimate means, his lifestyle will virtually be different from every other person in that environment. This will arouse suspicion as to how the person gets his income to meet the luxuries. A situation where a person is considered the best and only trusted person to carry out an assignment in the midst of others who have not been given the same opportunity to handle the same assignment sets an inquiry mind to ponder. This kind of situation creates room for all kinds of temptations starting from pilfering before advancing to more sophisticated types of fraud.

The lust for an assignment by an individual is an indication of unwholesome benefit from that assignment. That is why people who are used to the juicy benefits obtainable in an office resist being reassigned or transferred to another office. Where a person settles down on a job which is not his rightful place, even where he has been given a better option that is, by other people's judgment and perception, this calls for an inquisition. A tale bearer is a highly risky person in an environment. His movements have to be carefully monitored because most times, he is responsible for aiding and abetting fraudsters. He is an illegal transmitter of information for personal gain and aggrandizement.

People who give funny excuses for not wanting to go on leave in an organization even where it is clear to all and sundry in the organization that their absence will not even be noticed are very much likely to be involved in illicit activities within or across organizations. Similarly, those who do not need assistance from other workers when it is very clear that they cannot cope with their present job schedules alone are obviously engaging themselves in illicit activities. They do not want other people to discover their nefarious activities.

Where simple records are muddled up in an organisation, it creates room for all kinds of fraudulent malpractice. The muddling is done intentionally so as to confuse and cover their evil deeds. A close relation to muddling of records is arson. Arson is the deliberate criminal act of setting fire to a house or a building. This action is carried out where it becomes very clear to the arsonist that he will be caught red-handed. The easiest escape route he believes is to cause arson. Most often, the reason for taking this action is to conceal massive and enormous fraud that has taken place in the organization.

Where junior officers disobey senior officers who are known as no-nonsense senior officers, with reckless abandon in the carrying out of their official duties indicates the existence of an abnormality on the part of the senior officers. A good example is the relationship between subordinate officers to a Director of finance or between the Director of Finance and his Chief Executive. This relationship is not only peculiar to a finance department, it occurs in other departments in varying degrees of occurrence. The missing of files and records in an organization is a clear evidence of perpetration of illicit activities within the organization.

A greedy person is susceptible to fraudulent malpractices. His inability to satisfy his greed makes him to indulge in illicit activities. In an organisation where there is no system of internal control and internal checks, it will be a breeding ground for fraudulent activities. Where there is a system of internal control and internal checks in an organization but it is often by-passed, portrays the existence of fraudulent malpractice.

An important area where people are not always comfortable within an organization is the Internal Audit Department. One of the reasons for avoiding the Department is not to subject their papers to close Scrutiny. On the other hand, the antagonists of internal auditors are those who have skeletons in their cupboards. They do not want their disgraceful and ignominious activities uncovered. An organisation that abhors antagonists of internal auditors will suffer great loss of money and assets. An organization where there are frivolous purchases is a breeding ground for fraudulent malpractices. The officers buy all kinds of goods and services not useful to the organisation. They spend money recklessly on such frivolous items. They use such avenues to defraud the organization.

From the above, it can be seen that fraudsters find themselves in such acts as a result of one or all of the following reasons:

- (i) They take advantage of a weak or spurious system of internal control existing in the organisation. At times, the internal control merely exists on paper and not in practice.
- (ii) The organization has employed staff who are inherently fraudulent. Fraud is in their blood. It is a way of live for such people who are mistakenly in the employment of an organisation.
- (iii) The environment where they live or work exposes them to fraudulent malpractices. An organization where people steal money or asset without being challenged or reprimanded may stimulate an honest person to be tempted to commit fraud. Similarly, where there is a quantum of such

money or assets at their disposal and other take them away without questioning, large scale fraud may be perpetrated.

**e. Fraud Detection, Prevention and Deterrence in Nigeria**

This aspect requires professional skill and expertise, to detect, prevent and deter fraudulent individuals. In the area of money, finance and accounting, it requires the expertise of professional accountants and auditors who have undergone training in accounting and auditing together with practical training.

Investigation that involves torturing suspects can be used by police to obtain information from fraudster. But for a scientific and analytical approach of conducting investigations into accounting and other financial records, the accountants and auditors are best suited to carry out such assignments. Here comes the need for collaboration between the law enforcement agencies and the accountants/auditors for a thorough analytical investigation into fraudulent malpractices in an organisation.

Fraud cannot be easily detected, prevented or deterred in any environment, be it at home, organization or society at large except the investigators have adequate training and skill on fraud detection. The methods of detecting, preventing and deterring violent fraud are very much at variance with those of non-violent fraud except in the areas of principles and approach to fraud investigation. The primary aims of investigation are to detect, prevent and ascertain measures that will act as future deterrence.

In the case of violent fraud, the appropriate authority to tackle this menace is the police. In most cases, all the processes of investigation need the introduction of ruthlessness on the suspects. The reason for the ruthlessness is to bring the insanity of the gangsters to a level of sanity for them to be able to aid investigation into the crime. The fraudsters are “hardened criminals”. They are usually under the influence of hard and dangerous drugs that make them to loose their senses as normal human beings.

Hence, the first method to adopt in the investigation of violent fraud is the application of ruthlessness on the suspects. That is, the same methods of violence they usually apply on their victims are also applied on them. You brandish guns and dangerous weapons at them. You threaten to shoot and kill them. You use dangerous weapons on them as they do to their victims. You even fire shots at them in places that will not kill them because their deaths will hamper investigation in detecting the other culprits and their hideouts. It is only when you know their gangs, hideouts and methodology of operations that you can prevent and deter them from further operations in the environment.

After successfully bringing them to a level of sanity, were they are able to reason like human beings, you make them feel very good by occasionally promising them what the society consider as good things. While interviewing them, you should not let them know your purpose of doing it. You should treat the whole situation like a joke. Pretend to be their very good friend.

You should be determined in your mind and be prayerful so as not to be lured or carried away with the easily gotten gains and benefits associated with violent fraud. During the interaction stage, the investigations should be focused, skilled and bring to bear his professional training on fraud investigation.

In the case of non-violent fraud, you may realize that the preliminary processes of investigation used by the police are not too different from those applied in violent fraud. In a civilized society, this kind of preliminary processes of investigation used by the police on violent fraudsters is not allowed on suspects of non-violent fraudsters. This is because, there is little or no evidence to show that they are actually the people who perpetrated the fraud. It is only being suspected that they are involved or have inside knowledge of those who perpetrated the fraud because of the nature of their work in relation to the occurrence of the fraud. This is where the law enforcement agencies require the services of professional accountants. Professional accountants, by the nature of their study and training are people who are versed in the principles, concepts, theory and practice of accountancy. They are very useful in the investigation of non-violent fraud. They do not apply force in the process of investigation. They peruse all necessary and useful books of accounts, documents and records to ascertain the magnitude and perpetrators of the fraud. Therefore, the application of force and ruthlessness of non-violent fraudsters is an infringement on their fundamental human rights as guaranteed by the 1999 Constitution. They cannot be punished until it is proved and supported with enough documentary evidence that they are the perpetrators of the fraud. This is why the employment of professional accountant in the detection of non-violent fraud is important.

In order to detect non-violent fraud, the investigators should be reasonably equipped in terms of knowledge and training needed to carry out the given assignments. In this regard, they should have a good knowledge of the various functions being carried out by the organisation and the existing systems of controls.

The processes of investigation of non-violent fraud in an organization will include getting to know whether there are competent, trustworthy and honest personnel in the organization; whether there are clear-cut guidelines on the separation of duties, responsibilities and authority; the procedures for authorization of transactions; the types of records and documents used in processing transactions; the custody and control over records, and documents and assets of the organization; the existence of internal checks and internal control. The above are very fundamental in any investigation of fraud in an organization.

The investigation of fraud in a non-computerized environment is simpler when compared with that of a computerized environment. The reason why the investigation of fraud in a computerized environment is difficult may not be unconnected to the introductions of computers into various activities in Nigeria. The concept of computerization is not yet very welcome in Nigeria because of the various fears, ranging from fraudulent manipulations of computer hardware and software due to lack of knowledge on how to use computers to enhance operational effectiveness and efficiency.

For the purpose of recapitulation, the strategies for effective fraud detection, prevention and deterrence are anchored on the effective working of a well-established system of internal control and internal checks in both a computerized and non-computerized environments. There should be clear-cut lines of demarcation of authority and responsibility; proper procedures for preparing, checking and authorizing transactions; appropriate and adequate documents and records; physical control over



assets and records; and independent checks on activities and performance of assigned responsibilities.

### **Conclusion**

The rate of fraudulent practices is increasingly becoming very high in our society. The reasons for this high rate of malpractice are the poor state of our national economy; the detestable social values of our society; the high degree of lawlessness and financial recklessness; the absence of social welfare schemes and a host of others. These fraudulent practices, which have been classified into violent and non-violent frauds, also have different approaches in their processes of detection, prevention and deterrence.

Clearly, the consequences of ethical violations in accounting and finance are serious, even terminal in the case of some companies. According to most authorities (Anumaka 2007; Mcdamet, et.al, 1999; Mulford and Comiskey, 2002; Silverston and Sheetz, 2004; and Izedonmi, 2001) the best defence against ethical violation involving financial statement is a management team that is committed to implementing accounting ethics and forensic accounting which is a strong internal control mechanism.

### **Recommendation**

1. Code of corporate governance should be strictly enforced in Nigerian quoted companies. This will result to more reliability in the financial statement, thereby increasing the confidence of the investors. Al-Faki (2007) is right in his assertion that poor corporate governance is the major factor for financial institution distress in an economy.
2. Appropriate oversight functions should be exercised by senior management to effectively utilize the work conducted by internal and external auditors and recognize the importance of the control function they provided. Board members should be qualified for their positions, have a clear understanding of their role in corporate governance and should resist undue influence from management or outside political factors to compromise this role.
3. There is need to combine orthodox religious, moral instruction, qualitative and Spartan apprenticeship education at nursery, primary, secondary and even at the tertiary institutions of learning. Material wealth possession should be commensurate and not above the social imperatives of fairness and integrity.
4. Government should reduce the incidence of fraudulent practices in the country by providing basic amenities of life through the medium of social welfare schemes.
5. Enforcement of law and regulations to deter fraudulent practices and the high incidence of lawlessness and moral decadence which more often than not result to economic and financial crimes.

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