
THE ROLE OF INTERNAL CONTROL SYSTEM IN PREVENTING FRAUD AND MISAPPROPRIATION OF FUNDS IN THE PUBLIC SECTOR (A CASE STUDY OF AKWA IBOM STATE POLYTECHNIC)

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ABSTRACT

This study was on the role of internal control system in preventing fraud and misappropriation of funds in the public sector using Akwa Ibom State Polytechnic as Case study. To accomplish the research objectives, the study adopted the survey research design while the taro Yamane formula was used to select ninety-two (92) respondents as sample size. Instrument for the study was a self-developed Questionnaire and the forms were personally administered. Research questions and hypotheses were formulated to guide the study and the data were analyzed using simple percentage, likert scale method. Findings from the study revealed that Control environment prevent fraud and misappropriation of funds in the public sector. That Risk assessments prevent fraud and misappropriation of funds in the public sector. That Control activities help in preventing of fraud and misappropriation of fund in the public sector. That Information and communication help in preventing fraud and misappropriation of funds in the public sectors. The research work has provided useful recommendations such as: Institutions should ensure that internal auditing approaches are introduced to manage financial resources in schools for proper maintenance of school properties, adequate provision of infrastructural facilities and proper management of school funds, also Management should follow a strict and objective process of selecting accounting principles and personnel

KEYWORDS: Internal Control System, Fraud, Misappropriation, Funds, Public Sector and Akwa Ibom

Introduction

Internal controls are processes designed to provide reasonable assurance that management achieves effectiveness and efficiency of operations, reliability of financial reporting and compliance with applicable laws and regulations (Grant, Miller, & Alali, 2008). A system of internal control is a critical component of corporate management and a foundation for the safe and sound operation of an organization and can help to ensure that the goals and objectives of an organization is met and also ensures that the organization will achieve long-term profitability targets, and maintain reliable financial and managerial reporting (Mannan, 2008). Such a system can also help to ensure that the organization will comply with laws and regulations as well as policies, plans, internal rules and procedures, and decrease the risk of unexpected losses or damages to the organizations reputation.

The system of internal controls should emphasize on, proper identification measurement and monitoring of risks, control activities for each level of operation, creation of reliable information systems that promptly reports anomalies and detailed reporting of all operations and monitoring of all the activities (Opromolla 2010). Internal controls should have the following as its components, control environment, risk assessment, control activities, information and communication and monitoring activities (Basel Committee, 2011). These interrelated components of internal control must be present and functioning properly in order to have an adequate and functioning internal control system (Rezace, 1995).

1. CONCEPTUAL ISSUES

In the school environment with particular reference to Akwa State Polytechnic, there are many check and balances that are put in place to ensure effective internal control against fraud and misappropriations. These include:

The control environment Risk assessment and management Information management communication Monitoring and evaluation Control Activities.

- 1.1 **Control Environment:** The control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure. Control environment factors include the integrity, ethical values and competence of the entire people; management's philosophy and operating style; the way management assigns authority and responsibility, organizes and develops its people: and the attention and direction provided by the board of directors (COSO, 2011). In a study by Valentine, Godwin and Lucero (2002).
- 1.2 **Risk Assessment and Management:** Risk assessment is the identification and analysis of relevant risks which can impair the achievement of objectives, forming a basis for determining how the risks should be managed. This is informed by the fact that economic, industry, regulatory and operating conditions will continue to change. Mechanisms are needed to identify and deal with the special risks associated with change. According to the ILAPFF (2010), risks are assessed in order to determine the likelihood of an event occurring, the impact, and risk tolerance level. Once identified the risks are then classified as high, medium and low. Based on the accuracy of the assessment, risk tolerance level can then be determined. In order to determine whether risk management are effective, relevant risk information should be captured and communicated in a timely manner across the organization, enabling staffs, management and the board to carry out their responsibilities. (IIA: PPF, 1999)
- 1.3 **Information and Communication:** According to Ballick (2007), Communication is the exchange of useful information between and among people and organizations to support decisions and coordinate activities. Information should be communicated to management and other employees who need it in a form and within a timeframe that helps them to carry out their responsibilities. Communication with customers, Suppliers, regulators and other outside parties are also essential for effective internal control.

- 1.4 Monitoring and evaluation:** Internal control systems need to be monitored – a process that assesses the quality of the system’s performance over time. This is accomplished through ongoing monitoring activities, separate evaluations of combination of the two. According to NYSC Act of 2007 monitoring is the review of an organization’s activities and transactions to assess the quality of performance over time and to determine whether controls are effective. Management should focus monitoring efforts on internal control and achievement of the organization’s mission. For monitoring to be most effective, all employees need to understand the organization’s mission, objectives, risk tolerance levels and their own responsibilities.
- 1.5 Control Activities:** According to Ballick (2007) many different control activities can be used to counter the risks that threaten an organization’s success. Most control activities, however, can be grouped into two categories: detection and prevention Control activities. Prevention activities are designed to deter the occurrence of an undesirable event. The development of these controls involves predicting potential problems before they occur and implementing ways to avoid them. Detection activities are designed to identify undesirable events that do occur, and alert management about what has happened. Prevention controls tend to be more expensive than detection controls. Costs and benefits should be assessed before control activities are implemented. Management should also remember that an excessive use of prevention controls can impede productivity. No one control activity provides all of the answers to risk management problems. In some situations, a combination of control activities should be used, and in others, one control activity could substitute for another.

2. THEORETICAL ISSUES

2.1 SELF CONTROL THEORY

Hirschi (2010) as referred to in (Holtfreter, 2010) expresses that people with low levels of discretion will probably carry out a wide assortment of wrongdoing and wrongdoing related practices. Individuals lacking self-control have tendency to be incautious, uncaring, physical rather than mental, chance taking, shallow and nonverbal (McMullen, 2010). Presses that low poise is found out from youth through parental sustain Seemingly conflicting child rearing practices result in kids who can’t postpone satisfaction, maintain a strategic distance from dangerous conduct, control their motivations and consider the sentiments of others (Holtfreter, 2010). People with more elevated amounts of discretion have a tendency to understand the low likelihood of long haul advantage and high likelihood of trepidation is related with criminal endeavor (McMullen, 2010), Discretion is essential if fraud is to be voided from in any association

2.2 THE FRAND TRIANGLE THEORY

As indicated by Fraud Triangle Theory (Albrecht, 2009), fraud is made out of three components namely; a perceived pressure, a perceived opportunity and rationalization of the act of fraud. The three components are known as the misrepresentation triangle. Each act of fraud, regardless of whether done against a substance or for the benefit of an element, is constantly made out of the three components (Albrecht, 2009). The components in the fraud

triangle are intelligent, for example the greater the perceived opportunity or the more intense the pressure, the less rationalization it takes for someone to commit fraud (Albrecht, 2009). This hypothesis is a mind boggling matter and is a component of a blend of variables (Rae and Subramaniam, 2008).

At times, albeit interior controls were poor, there were no episodes of extortion. While in different cases despite the fact that great inward controls existed workers ill figured out how to evade the inside controls to submit misrepresentation (Rae and Subramaniam, 2008). Understanding of how opportunities, pressures and rationalizations contribute to fraud in associations help to effectively perceive the regions of helplessness to misrepresentation and reinforce (Albrecht, 2009). Misrepresentation culprits have had approaches to justify their activities as being satisfactory (Albrecht, 2009), Support of any false conduct is because of a fraudster's absence of individual honesty or other good thinking (Rae and Subrama 2008). People tend not to submit extortion unless they can legitimize it as being reliable with their very own code of morals, since individual trustworthiness might be the key constraining component in shielding a man from misusing resources (Hillison, 2009), Justification by fraudsters comes about because of the inclination that the casualties owe them and along these lines, they merit more than they are getting (Mutua, 2011). A few people have a disposition, character or set of moral esteems that enable them to purposely and deliberately submit unscrupulous acts (Cohen, 2011). Strong moral code much of the time keep people from utilizing justifications to legitimize unlawful conduct; inward examiners however ought to expect that anybody is equipped for advocating the commission of fraud (Hillison, 2009).

3. EMPIRICAL REVIEW

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 rationalisation, 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).

Employee theft has been found to be influenced by organization's work climate (Weber et al., 2003; Appelbaum et al., 2006; Kulas et al., 2007) and employees attitudes toward honesty (Greenberg, 2002). It has also been determined that organizational variables might be more likely to influence deviance directed at harming organizations (Robinson and Bennet, 1995). Rae and Subramaniam (2008) found the quality of internal control procedures has a moderating effect on the relationship between perceptions of organizational justies and fraud. The authors suggest that strategies relating to fraud need to focus on organizational factors such as work environment, internal control activities, and training. The importance of internal

control mechanisms in curbing fraud-bent behaviour, specifically employee fraud, has been investigated. Studies relating to internal controls provide relevant. Albeit limited, research concerning employee fraud (O'Leary's et al; 2006). Employees' perceptions on both certainty and severity of organizational sanctions were found to be related to employee theft (Hollinger and Clark, 1983).

Holmes et al (2002) found that whenever top management firmly supports internal control, internal perpetrators and fraud were less likely to occur. Another study found that access to various control mechanism alone does not curb losses due to fraud (Holtfreter, 2004). Breaking the Fraud Triangle is the key to fraud detection. Breaking the Fraud Triangle implies that an organization must remove one of the elements in the fraud triangle in order to reduce the likelihood of fraudulent activities. Out of the three elements, removal of opportunity is most directly affected by the system of internal controls and generally provides the most actionable route to detection of fraud. (CresseyCendrowski, et al, 2002) A positive association was found between ethical environment and employee organizational commitment. Based on a sample of 304 young working adults, Valentine et al (2002) found that ethical environment was positively and significantly associated with the level of employees' organizational commitment. Furthermore, in a recent study, Leese (2004) studied audit papers of 60 information systems audit engagements and found that the ethical tone of the audit clients' management has a significant impact on the strength of their security controls. Effect Of Internal Control On Fraud Detection.

4. RECOMMENDATIONS

Control system should address the risks associated with the financial management of the agency and clearly articulate expectations and internal accountabilities for management of these risks. It is important to note that the public sector must have an internal audit department that is adequately functioning to ensure that their accounting systems provide an efficient means of recording and reporting financial transactions, providing management information and protecting the public's asset from fraud and misappropriation (Bukky, 2006).

This give rise to the following recommendations:

- Institutions should ensure that internal auditing approaches are introduced to manage financial resources in schools for proper maintenance of school properties, adequate provision of infrastructural facilities and proper management of school funds.
- Staff performing internal control functions in Akwa Ibom State Polytechnic should be given adequate training
- Management should follow a strict and objective process of selecting accounting principles and personnel
- Financial reports should be kept and published annually
- Accounting and auditing departments should be empowered to improve the level of internal control system of the organization
- Management should ensure that sensitive accounting and financial data and information are protected with password.

- Management should ensure that all assets of the school are adequately protected
- There is need to monitor all the internal control system closely
- Qualified personnel should be employed to carry out the operations of internal audit in schools as this tends to redirect fraud and irregularities in the organization.

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