

EFFECT OF FORENSIC ACCOUNTING SERVICES ON FRAUD DETECTION ON MICRO FINANCE INSTITUTIONS IN BOMET COUNTY

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Abstract: Fraud is one of the major problems facing accounting environment industry in Kenya and it impact negatively to the whole of micro finance institution's sector. Fraudulent practices in MFI's have led to increase of losses and collapse of many of MFI's sector, hence the need to use investigating accounting services to detect such fraudulent activities. The MFI's industry is a very important institution in the segment of entrepreneur environments with many internal controls in order to overcome the fraudulent practices. The objective of this study was to investigate the effects of forensic accounting services on fraud detection on microfinance institutions in Bomet County, the specific objectives of this study were; to establish the effects of internal control; to determine the effects of information and technology; to establish effects of control environment and to moderate the effects of Government policy. The study used primary data. An ordinary linear regression model was used. The regressions were conducted using statistical package for social sciences (SPSS) version 20. The regression results indicated that there was negative and significant relationship effects of internal control and level of fraud prevention and detection. The results also indicated that there is a negative and significant relationship between effects of information and technology and level of fraud prevention and detection while the relationship between control environment and level of fraud prevention and detection was positive and significant. Following the study findings, the study recommended that MFIs should fully reconcile their accounts more frequently in order to reduce the cases of more incidences of frauds. The study also recommends that MFIs should put in place stronger financial governance control measures through more frequent meetings among the members of the risk management committee and also finance and investment committee. Another recommendation made by the study is that MFIs should reduce the variances in budgets through better reporting and budgetary control measures as it was reduce cases of frauds.

Keywords: EFFECTS, FRAUD DETECTION, MICRO FINANCE INSTITUTIONS.

1. INTRODUCTION

Background to the Study:

Forensic accounting is the specialty area of the accountancy profession which describes engagements that result from actual or anticipated disputes or litigation. "forensic" means "suitable for use in a court of law", and it is to that standard and potential outcome that forensic accountants generally have to work (Crumbley, Heitger, and Smith, 2005). Forensic accounting can also be seen as an aspect of accounting that is suitable for legal review and offering the highest level of assurance (Apostolou, Hassell, and Webber, 2000).

The widespread frauds in modern organizations have made traditional auditing and investigation inefficient and ineffective in the detection and prevention of the various types of frauds confronting businesses world-wide. (Onuorah and Appah, 2012) The incidence of fraud continues to increase across private and public sector organizations and across nations. Fraud is a universal problem as no nation is resistant, although developing countries and their various states suffer the most pain.

Today; modern organized financial crimes have appeared. Financial crimes such as employee theft, payroll frauds, fraudulent billing systems, management theft, corporate frauds, insurance fraud, embezzlement, bribery, bankruptcy, security fraud (EFCC, 2004), among others, have taken the centre stage in the scheme of things; and on the scale of private, public and governmental preference. Financial crimes today have grown wild, and the emergence of computer software coupled with the advent of internet facilities has compounded the problem of financial crimes. Besides, the detection or minimization of these crimes are made more difficult and committing these crimes much easier. (Izedonmi, and Ibadin, 2012). All these, no doubt, remain outside the ambit of the statutory auditor to report on except he is placed on inquiry.

Statement of the Problem:

Many studies have been done on effect of forensic accounting services. Okunbor et al (2010) for instance found out that forensic accounting services were not effective in deterrence of fraud. In another perspective, Owojori et al (2008) in the study of forensic accounting, the vexed problems in the corporate world, concluded that forensic accounting is the best ever growing areas of accounting that enables in enhancing the chances of success in day today life of corporate firm. Wanjohi (2011) on rationale for use of forensic accounting in reducing audit expectation gap in Kenya and introduction of forensic audit as a mechanism in reducing audit expectations gap. He established that forensic accounting is important in reducing audit expectation gap. Kimani (2011) looked at fraud risk assessment plan for Barclays bank of Kenya. He found out that fraud risk assessment provided a comprehensive step by step model that could be utilized in preventing further fraudulent activities. Gakenia (2008) looked at the role of forensic accounting in combating the shortage of fraud examiners and established that knowledge of forensic accounting in Kenya can reduce corporate fraud and mismanagement.

It has been claimed by some researchers such as Gichira and Thambo (2003) that some firms in Kenya have collapsed due to fraudulent activities perpetrated by management and employees. While case law for example, Euro Bank Scandal which led to collapse of Nairobi based Euro Bank in February 2003 due to a loss of 1.4 billion Kenya shillings which state corporations had deposited. Micro finance institutions in Bomet County have not been left behind either as fraud detections has forced closure of some institutions, It has constraints their credit management, It has diminished their operations capabilities and last and not the least mfi's expansions of their business.

2. LITERATURE REVIEW

Punishment-Deterrence Theory of Punitive Damages (Putney 2004):

“Damage” was denned to be the loss caused by one person to another, either to his person, property or relative rights, through design, carelessness or default, while 'damages' are the indemnity recoverable by the injured party from the party who has caused the injury (Putney, 2004). The general theory upon which the law allows damages for the violation of a civil right is based upon the doctrine that where a civil injury has been sustained the law provides a remedy that should be commensurate to the injury sustained.

White Collar Crime Theory of Fraud (Edwin 1939):

Edwin Sutherland in 1939 was the first to coin the term White collar crime. It means, a crime committed by a person of respectability and high social status in the course of his occupation (Sutherland, 1949). Crimes committed by corporations were also included. Sutherland originally presented his theory in an address to the American Sociological Society in an attempt to study two field, crime and high society which had no previous empirical correlation. White collar criminals attributed different characteristics and motives than typical street criminals. He used the concept to challenge conventional stereotypes and theories.

Labeling Theory of Crime (Howard 1963):

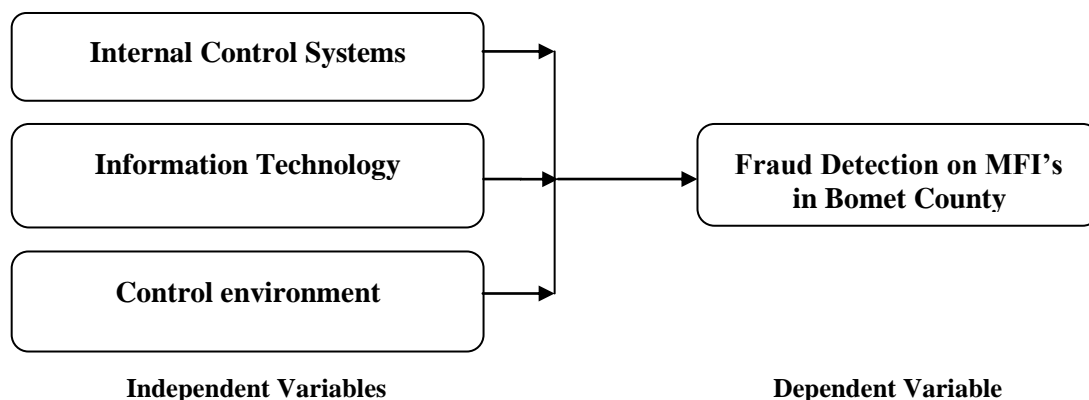
It was propounded by Howard Becker in 1963. Labeling theory sees criminal behavior as being defined by society. It holds that the deviance is not inherent to an act but instead focuses on the tendency of majorities to negatively label the minorities or those seen as deviant from standard cultural norms. According to Becker (1963), deviance is not a quality of the act a person commits but rather a consequence of the application by other rules and sanctions to a defender. Behavior in this case is not seen as wrong rather as a deviant behavior. This argument also applies to other groups in society such as the mentally ill. Gove (1975) examines the consequences of labeling—the creation of stigma and the modification of self-image.

Theory of Mindset and Problem Representation:

Mindset is a general cognitive orientation with distinct features that guide individuals in the collection and interpretation of information (Gollwitzer, 1996). It influences how individuals process information and shapes their thought production and way of thinking. Mindset impacts decision making through its effects on the way in which individuals process task-related information (Beckmann and Gollwitzer, 1987). Preliminary individuals with a particular way of thinking can cognitively evoke in them a focus on information consistent with the mindset and subsequently lead them to search for pertinent information (Gollwitzer, 1990).

Conceptual Framework:

A conceptual framework is a basic structure that consists of certain abstract blocks which represent the observational, the experiential and the analytical/ synthetically aspects of a process or system being conceived. The interconnection of these blocks completes the framework for certain expected outcomes.



3. RESEARCH, FINDINGS AND DISCUSSION

Response Rate:

Demographic information of sample population, of the 121 questionnaires issued for this study 115 were returned while 6 were not returned this represents 95% of the questionnaires under study that were returned while 10% were not returned. According to Mugenda and Mugenda (2003) any study that has more than 50% respondents rate qualifies to be adequate for the study.

Test of Instruments:

Mugenda and Mugenda (2003) alleged that any research carried out needs to be similar to any other research carried out in the same subject or to have a slight or minimal variation.

Reliability and Validity of the Instrument:

Validity and Reliability of the tools resulted from the extent to which responses of the field reflected theories and empirical evidence of other scholars who have studied similar variables. The main tool of data collection used was the Likert-scale questionnaire. The instrument was reviewed and tested by university experts in statistics and strategic fields using Cronbach's alpha test. Nachmias and Nachmias (2006), has explained that a Cronbach's alpha test confirms the reliability and consistency of the research. The results of the test are summarized in table

From table the questionnaire instrument consistently returned high scores averaging 0.8 which is highly acceptable since Cronbach's alpha coefficient of over 0.7 qualifies an instrument as reliable and consistent (Nachmias & Nachmias, 2006; Kent, 2001; Kothari, 2004; Sekaran, 2006).

Test of reliability and inter-correlations of study variables (Cranach's alpha coefficient)

	Internal Control Systems	Information Technology	Control environment	Government Policy
Mean	4.36	3.64	4.81	3.71
Standard error	0.78	0.44	1.11	0.18
Internal Control Systems	0.812*			
Information Technology	0.591	0.801*		
Control environment	0.739	0.436	0.834*	
Government Policy	0.08	0.111	0.156	0.864*

Note: The diagonal numbers indicate alpha coefficients

Descriptive Analysis:

The main characteristics of the data are quantitatively described in the descriptive statistics. In the descriptive statistics summaries about the sample population responses are provided. The mean, median, mode, minimum, maximum, the standard deviation and the skewedness in relation to the independent, dependent and mediating variables are presented in the table below.

Table: Independent and Dependent with the mean, median, mode, standard deviation and skewedness

	Variable	No of Measures	Min	Max	Mean	Median	Mode	Std	Skewedness
	Independent Variables								
1	Internal Control Systems	18	2	5	3.92	4	4	0.68	-0.68
2	Information Technology	13	2	5	3.8	4	4	0.7	-0.21
3	Control environment	6	2	5	3.97	4	4	0.68	-0.6
4	Dependent variable								
	Fraud Detection on MFI's in Bomet County	15	2	5	3.84	4	4	0.54	-0.3

4. SUMMARY, CONCLUSION, AND RECOMMENDATION

The objective of the study was to establish the impact of internal control systems services on fraud detection in MFIs in Bomet County of Kenya. Primary data was collected from the audit and risk departments of MFIs and a regression analysis carried out. Red flag occurrences were used as the proxy for fraud detection. This chapter discusses the summary of the research findings based on the study objectives, the conclusion, the study limitations, policy recommendations, and suggestions for further studies.

Summary of Major Findings:

The study found out that MFIs in Bomet County of Kenya are aware of the attributes of forensic auditing because of the organizations had a forensic auditing department and actively applied internal control systems services. The study revealed that investigation services impact mainly on fraud detection through probing suspect financial transactions, fraud risk assessment, and looking for alleged fraud. The study also showed that Information Technology affects fraud detection mainly through financial analysis for damages and the discovery and preparation of interrogation reports.

Relationship between Fraud reductions, Information technology systems and the Control Systems:

The study showed that MFIs have internal control systems to combat fraud and they include individuals are brought to book, adherence to policy documents aligned with the laws of Kenya, prosecution of suspects, an ethical code of conduct, and training staff on detection and preventive strategies. Internal control systems had the highest application in controlling financial statement fraud followed by Information Technology while Control environment had the least application. The study also revealed that the most common frauds in the Kenyan MFIs sector were payroll fraud followed by procurement fraud and theft of cash, physical assets, and confidential information while corporate identity theft was the least occurring fraud.

Conclusion:

The study, therefore, concludes that the role of forensic auditors in fraud detection in MFIs is crucial. It can be established that MFIs are likely to identify the occurrence of fraudulent activities by applying internal control systems and Information Technology. Forensic auditors help lawyers and courts through the use of auditing, investigative, and accounting principles in solving fraud cases. The impact of fraudulent activities is a major setback on the financial sector because it reduces customer and investor confidence. In Kenya and also Bomet county, perpetrators of fraud are rarely prosecuted and but forensic auditors was provide evidence to the courts, and this was see individuals who commit fraud sentenced, and this was assist in improving the reputation of the industry. The study also concludes that MFIS in Kenya have adopted internal control systems and Information Technology.

Recommendations of the Study:

The study makes the following recommendations about forensic audit services MFIs in Bomet County in Kenya. The recommendations are consistent with the literature review. The study recommends that the institutional infrastructure that supports fraud prosecution should be improved. This was involve restructuring the laws, offering advanced training to the police, lawyers, and judges in the issue of banking fraud. Also, the public institutions charged with dealing with fraud cases should be reformed to enable them carry out their duties effectively. An efficient fraud prosecution system where the fraud perpetrators was sentenced was go a long way in enhancing fraud detection and deterring future fraudulent events in the banking sector.

MFIs should revise their organizational structure to allow for better alignment with the functions of forensic auditing department. A more hands-on approach is needed to fraud detection, and this requires proper structures and policies that separate and guide the role of the forensic auditing department from others. This was ensure that the department was work without interference from anyone and avoid any conflict within the organization.

Fraud detection and preventive strategies should be the start with the BOD and the management. Management should take a proactive approach towards the identification of fraud by setting a specific tone about fraud. This involves communicating the organization's policies and procedures to all stakeholders. The tone at the top makes the forensic auditors work of identifying fraud easier as well as encouraging whistleblowers when a red flag is noticed. A corporate fraud policy which directs the employees on what they should do when fraud is suspected should be developed. Such a policy gives the course of action on how the organization deals with fraud and communicate that no individual has the authority to engage in fraudulent activities, even to the benefit of the company.

The management and employees should undergo training on fraud identification and prevention strategies. The training teaches them on the factors that indicate fraud and the steps that they should take. Also, they should be trained on the internal controls as well as the organization's procedures. Employees should be aware of the consequences of committing fraud, and this was ensure that they follow the set guidelines and regulations.

Suggestions for Further Research:

The study did not consider the factors that affect the adoption of forensic audit services in the Kenyan financial sector. Therefore, another study should focus on the factors influencing the adoption of forensic auditing in Kenyan financial sector. The study has considered organizations in the financial sector. Another study should focus on another sector such as manufacturing or use the firms listed on the Nairobi Stock Exchange.

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