

# The Changing Responsibilities of Auditors in Detection and Prevention of Business Frauds within a Challenging Environment in Nigeria

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## Abstract

*The cost of fraud to business is enormous; everyone is victimized by high product cost and lower corporate profits. When fraud is detected within a business, there is usually shock and disbelief that a trusted employee who resembles the "person next door" could have done what they are accused of. Why didn't the auditor foresee the problem? This is the question frequently asked during this period. A logical response is that the people involved in perpetrating the fraud were clever enough to conceal the fraud. In reality, however, the blame has been increasingly placed on the auditors, which often show a lack of understanding as to what the role of the auditors should be, but has the auditors roles changed? In the light of cost of frauds to the business and the offender, it is important to develop strategies to prevent and detect business fraud, taking a cursory look at the risk factors associated with business and given due attention to the motives attached with it, and how to effectively manage it on daily basis. Having focus on public expectation and the new expectations for the auditors, this paper will examine the responsibility of external auditors and the management.*

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**Keywords:** auditor, fraud, risk, prevention, management, motives

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## INTRODUCTION

Fraud, according to Webster's Dictionary is the intentional deception to cause a person to give up property or some lawful rights. Federal Bureau of investigation defined fraud as the fraudulent conversion and obtaining of money or property by false pretense; included are larcenies by bailee and bad checks, except a forgeries and counterfeiting (FBI 1984:342). Recent time definitions of fraud state that it is an act of deliberate deception with the intention of gaining some benefit. The root of the word fraud is "fraus, fraudis" the Latin word for trick. It is therefore clear that fraud in one form or the other has been with us for a long time and is characterized by deception or concealment perpetrated deliberately and often perpetuated with other accomplices with a view to obtaining unfair advantage and for benefit to which they are not entitled. Fraud and its root 'greed and arrogance' are human nature. As business people, we must recognize fraud as a permanent risk, a risk we must take action to manage. It is a commonplace that we live in a world of accelerating change, but change is creating greater incentive for fraud and greater opportunities to defraud.

Fraud has become an industry, not just for fraudsters, Academics study it, investigators explore it, lawyers litigate on it, but all this industry is built on managing the consequences of fraud rather than on preventing fraud, even publication reflect the same pattern but little has been offered by way of practical advice on what business should do to

manage fraud risk from day- to-day. The common trend among these definitions is that fraud is a deliberate deception for the gratification of individual or group. Fraud requires a theft, often accompanied by concealment of the theft, and the translation of the stolen asset or resources into personal assets or resources

## Managing Risk of Fraud

Any company is at risk of fraud and it is the directors' task to manage such risk in a professional manner. They must apply to it the same techniques, which are applied to all business problems i.e. analyzing the scope and scale of the risk, developing a strategy to minimize the risk and carefully implementing the strategy. However, managing the fraud risk is difficult because it is plausible. Fraudsters are experts at manipulating people, documents, situations and the slightest opportunity. They are equally good at covering their tracks.

The appearance may therefore be normal but the reality quite different; deception is the key to any fraud. Many companies tend to narrow their field of vision by looking only at accounting procedures and controls rather than the specific risks of frauds that the business faces. They do not take account of the whole spectrum of risk. The fraudster is not only interested in the straight forward and often highly visible cash but also the

- Ability of the business to generate credit e.g. through loans

- Power to commit the business to contract to accept liability and to approve invoices
- Contingent assets and rights to commercial secrets
- Ability to control resources and accounting records under separate legal ownership e.g. relating to pension or trust funds and client account.

Accounting procedures and controls may give a false sense of security. They may operate quite differently in theory than in practice. Fraudsters are opportunists who take advantage of temporary weaknesses or unnoticed gaps between the apparent strength and the real effectiveness of controls.

It is important to appreciate the nature of the risk and to remember that it is people, not the business, system or ghost who commit fraud. Some companies have taken special measures to counter fraud, for example by appointing security officers or setting up dedicated fraud investigation units. Sometimes these units deal only with fraud which is reported to them and do not play a proactive role in helping directors and managers to manage the risk of fraud in the business. The focus may also be only on external threats (e.g. in banks, cheque and credit cards fraud), overlooking what may be the greater threat, the enemy within. It is a known fact that a very high proportion of corporate fraud is committed by, or in collusion with management and employees.

Other companies focussed on specialized frauds affecting their particular industry e.g. airline ticket fraud in airlines but ignore more general type of frauds e.g. procurement fraud, which may be a significant risk for any company in relation to major capital projects, maintenance, design or consultancy contracts. It is critical therefore that effort are made to consider all the circumstances peculiar to the clients situation whilst assessing the management of risk due to fraud, particular attention must be paid to the control environment as well as the specialised nature of the clients business.

#### **Indicators of and Motives for Fraud**

##### **Indicators**

In several instances when fraud is uncovered, certain factors are also observed which, with benefit of hindsight should have put the company on notice that all is not well. These factors make the company susceptible to fraud and should be given due attention during the risk appraisal process. Some of these factors are considered as follows:

##### **A) Personnel Risk**

Changes in senior personnel may affect the culture of the company, changes in reporting lines, in segregation of duties or the competence of personnel may undermine the apparent controls. Other personnel risks include

- Autocratic management style
- Mismatch of personality and status
- Illegal acts
- Expensive life style

- Untaken holidays
- Poor quality staff
- Low morale
- High staff turnover
- Compensation tied to performances

##### **B) Cultural Risk**

Setting goals is an essential management tools but when it is an obsession, and set financial goals must be met at all costs by any means, long term productivity, efficiency and probity must suffer. Management are inclined to manipulate result to ensure goal achievement on paper. Other cultural risk include

- Poor commitment to control
- No code of business ethics
- Unquestioning obedience of staff

Look closely at those who follow procedure by rote, no initiative, passive, docile, in awe of superiors, nothing is questioned. This is recipe for collusion.

##### **C) Structural Risk**

Most companies have complex structures; several of reported frauds in recent years have involved the use of parallel private organisation i.e. private companies under common ownership surrounding a large public company. Where these are encountered, the auditor must try to study the set-up carefully, what is the justification for them? Be concerned even where there are plausible explanations. Other structural risks include

- Remote locations not properly supervised
- Several firms of auditors within a group

##### **D) Business Risks**

All businesses have risks which they run. Corporate strategy and policy are crucial to fraud inhibition. Poor corporate strategy and policy breed an overall weak organisation in which fraud thrives. Other fraud inducing business risks are

- Profits far in excess of industry norms
- Mismatch between growth and system development
- Poor reputation
- Liquidity problems

##### **Motives**

People commit fraud when a motive coincides with an opportunity. The motive may be greed, lack of cash, revenge, and boredom, a sense of ownership of the stolen property or of having earned it. The opportunity may arise because there is no real deterrent or little chance of discovery, or because there are gray areas in the rules. Over time, the number of people who have the potential to commit fraud in a company is large. This makes it all the more important for companies to create an environment which inhibits fraud.

##### **Business Crime Raises Question about Auditors**

It is noteworthy that assaults on the public by those in business, politics and the professions wreak much more havoc than those committed by street

offenders, fraudulent behaviours can include not only the companies, but on a larger scale may have direct impact on the health and well being of the public or other employee at the corporation.

Some fraudulent behavior may include cutting costs, spending corporate and shareholder money on personal expenses and manipulating financial records for personal needs.

#### **Auditors Responsibility to Consider Fraud**

The auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Due to the nature of audit evidence and the characteristic of fraud, the auditor is able to obtain reasonable, but not absolute, assurance that material misstatements are detected.

In an attempt to stifle the criticism and appropriately respond to the public demand for improved auditors performances ISA 240 ushers auditors into a much wider arena of procedures aimed at detecting frauds. The auditor is now required to consider fraud at every stage of the audit process; this consideration must be seamlessly blended into the audit process and be continually updated until the audit completion.

Although the public constantly expect auditors to uncover fraud, they are not charged specifically with the duties of fraud detection since reliance is heavily placed on the management to provide information and documentation; small scale fraud is extremely difficult for auditors to detect, particularly if it is being perpetrated by more than one key staff within organization. SAS NO.82 issued by American institute of certified public accountant detailed the auditor responsibility to detect and report material misstatement in financial statement due to fraud. He is required to consider forty-one risk factors relating to fraudulent financial reporting and misappropriation of assets when designing an audit plan. Furthermore, the plan needs to be continuously modified during the audit on the basis of information gathered concerning these factors. However, auditors must still use subjective judgment in analyzing the many risk factors e.g. one risk factor to be assessed by the auditors is management display a significant disregard to regulatory authorities.

International Auditing standard maintain that an auditor's mandate may require him to take cognizance and report matters that come to his knowledge in performing his duties, which relate to compliance with legislative or regulatory requirement, adequacy of accounting and control system, viability of economic activities, programmes and projects.

Lately, a view has emerged that auditors should play a more vital and direct role in establishing good governance, if this means to expect them to cross the established borders of genuine audit functions, it would be stretching the string too far, without

gaining anything positive and substantial. The only alternative then is to make the auditors feel more conscientious, more dutiful and therefore, be more effective, while restricting themselves to their term of references.

#### **The Cost of Fraud to Business**

The ways in which companies may suffer loss due to fraud include

- a. Removal of funds or assets from the business. This include theft of cash from bank account, removal of other asset such as stock, manipulation of companies relationship with suppliers or customers, overstatement of claims, undisclosed creation of credits and assumption of liabilities.
- b. Misrepresentation of the financial position of the business, which include false accounting such as omissions, mis-recording and manipulation of the company's accounting records. It must be stressed again that when all these nefarious acts are committed with a view to obtain undue advantage or benefit, a fraud has occurred.

The cost of fraud to business is difficult to estimate because not all fraud and abuse are discovered, not all uncovered fraud is reported, and civil and criminal actions are not always pursued. A conservative estimate of the cost to organizations is approximately 6% of annual revenue (Association of fraud examiners 1999). To quantify other indirect costs like legal costs, accounting costs, insurance costs and loss of productivity associated with hiring and firing employees to the business is outside the scope of this paper. Experts agree that companies usually suffer similar losses and organizations are paying for them through their normal operating expenses. Data show that the overall cost of fraud is over double the amount of missing money or assets. As computerized systems become more complex, so is the expected cost of fraud.

#### **The Cost of Frauds to the Offenders**

It is the trusted and valued employee who generally commits business fraud. When fraud are uncovered, there is often shock and disbelief that they have committed such acts, the perpetrator of business fraud could be 'the person next door' this person is likely to be a married male with a family, a religious affiliate, and above average education.

In most cases offenders do not view stealing from companies as harmful, they may think that the crime was victimless; and that they do not view their theft as being devastating or costly to the business. Many frauds occur because the opportunity exists and the perpetrator does not believe he/she will be caught. In many cases, the offender has little or no criminal self concept and offenders view violations as part of their work. They usually minimize their crime since it results in minor losses for a large volume of clients. No one client is usually targeted for the crime.

## METHODOLOGY

This study aimed at determining the variation in the opinion of those working in auditing firms, and whether years of experience as professionals affected respondent opinions. Questionnaire designed was administered on 300 respondents. The response rate was 60%; the respondents were primarily managers and partners.

The questionnaire was developed to focus on the following issues

- How auditors feel about the expectation of public as to detection of frauds
- If they felt they were being asked to be detective for the profession
- If they felt there was significant amount of blame being placed on the auditors for irregularities that have occurred in the past
- If the general trend towards accounting profession was becoming significantly more conservative
- If they have to make their career choice over again, would they still choose the field of accounting?

Respondents were asked to answer the questions using Likert response option ranging from 1 (strongly disagree) to 5 (strongly agree) with 3 as neutral.

## FINDINGS

Table 1: Should The Auditors Responsibility Include Searching For Fraud?

	NUMBER	%
AGREED	52	29
NEUTRAL	18	10
DISAGREEE	110	61
	180	100

Over 61% of the respondent disagreed that they should be searching for fraud, 10% were neutral indicating a desire to maintain current audit standard rather than to change, this may be typical responses of accountant until they experience the actual impact of the changes. Clearly, the findings of the auditors concerning their responsibility is not widely held by the public at large, after the collapse of some commercial banks in Nigeria and distress witness in some company being audited, the trust of the public were betrayed as to what the responsibility of Auditors should be? If they cannot detect management fraud and employee fraud concealed by their client, yet the auditors appeared unaware of the financial irregularities.

Table 2: Should The Auditors Act as Police or Detective When Conducting an Audit?

	NUMBER	%
AGREED	79	44
NEUTRAL	33	18
DISAGREED	68	38
	180	100

Many people within the auditing firm have stated that they feel they are being asked to be detective for the business community, they felt what is being asked of them should be the responsibility of the Certified Fraud Examiner (CFE). An issue often raised is how auditors can perform their duties when they have healthy level of doubt about the assertion in the financial statements. Respondents were asked the questions? 38% disagree with the statement with a resounding NO, while 18% of the respondent was neutral indicating a strong desire for the auditors to maintain only those responsibility they perceived as key to their role in the audit procedures; 44% embrace it and agree that auditors should act as detective for the organization.

## CONCLUSION

The primary responsibility for the prevention and detection of fraud rest with those charged with governance of the entity and with the management. This is best achieved through fraud prevention deterrence, detection facilitation and swift punishment when it occurs. A culture of zero tolerance, involving honesty, ethical behaviours, and strong set of core value set in a positive work place, environment with hiring, training and adequately compensating highly motivated employee could help. Internal control adequate for circumstances of the client and sound control environment ensures an orderly and efficient conduct of the entity's business from which reliable data for preparing credible financial statement would emanate.

An auditor conducting an audit in accordance with Nigerian standard on Auditing (NSA) obtains reasonable assurance that the financial statement taken as a whole are free from material misstatement, whether caused by error or fraud. A cursory look at recent high profile corporate failure demonstrate that the auditors suffers as much if not much more than anybody when things go wrong. The case of Enron and Anderson is still fresh in our memory; therefore, it is the auditor interest that all aspects of the audit are taken very seriously. Nothing should be left to chance and indeed the provision of NSA and other professional statutory requirement should be regarded as the barest minimum. All stakeholders expect much more from the auditors than what the NSA or statute prescribe. In the untrained mind of many shareholders, once there is an auditor nothing should go wrong. He is just not a professional; he is like a magician possessing the magic wand which ensures that nothing goes missing. An audit is a spot check of information not an exhaustive review of all financial transactions. Auditors are charged with determining the accuracy of the financial statement only "in all material respect". A clean bill from the auditor means that he is convinced that all the financial statement do not misrepresent the organisation's financial position in

any significant way. Auditors should embrace their responsibility to be more alert, more watchful, ask questions and to be whistle blowers if needed, but that they are ready to be detectives, going down dark alleys looking for clues when there is no visible evidence that a crime has been committed.

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