PDF - INTERNAL AUDIT AN EFFECTIVE TOOL FOR FRAUD CONTROL IN A MANUFACTURING ORGANIZATION (A CASE STUDY OF MICHELLE LABORATORY PLC) - researchcub.info**CHAPTER ONE**

## INTRODUCTION

### Background to the study

Fraud is the International distortion of financial statements or other records by a person (internal or external) to the organizational which is carried out to conceal the misappropriation of assets or otherwise for gain "(Adeniji 2004 and institute of chartered accountant Nigeria – ICAN 2006).

However,auditors have a significant role to play in the detection and prevention of fraud because they are not only agents of shareholders but their access to internal and external information makes them efficient monitor (Dyck, Morse &Zingales, 2008).The existence and in fact, the high incidence of fraud in company brings to mind the question of competence, skills, due care, honesty, and integrity of auditors in company or business enterprise, qualities are expected to be displayed by an auditor in every time in every circumstances (Olofin, 2005 &Agbaje, 2007).

Lorsase (2004) notes that when fraud occurs in work place, the question asked is "where were accountants and auditors? That an auditor has the responsibility for the prevention, detection, and reporting of fraud, and illegal acts and errors is one of the most controversial issues in auditing, and has been one of the most frequently debated areas amongst auditors, politicians, media, regulators and the public (Gay & Roger,2002) However, there seems to be misconception that auditors duties are largely the preventing, detecting and reporting of fraud (Idris, 2009). The internal audit unit is vested with the power of independent checks, in order to access compliance with established rules and regulations of the company (Okoya, 2002).Despite the fact that audit exist in various company with internal control system in place, but the act of financial crime still continues e.g. fraud, irregularities and even breaches of other control and no any strong measures being taken to prevent such occurrence.

Auditors are primarily concerned about fraud as it relates to misstatement in the financial statement (Bells &Carcello, 2000). So, auditing has a greater impact in the control of fraud and financial irregularities in companies that make effective use of their auditing system .The study tends to identify financial report users' perceptions of the extent of fraud in company and to determine their perceptions of the auditor's responsibilities.

Moreover, according to the Institute of International Auditors (1991), the internal audit unit is expected to review the means of safeguarding assets and where appropriate, verify the existence of such assets. Financial control has concentrated on the cash out flow, purchasing procedures and accountability of budget holders for current expenditure on resources inputs (Mainoma, 2007) and (Buhari, 2001). Therefore, internal auditing furnishes authorities with analysis, appraisals, recommendations and information concerning all activities reviewed. The survival of every organization depends on it effective and efficient utilization of resources (both financial and non-financial).The internal audit unit is vested with the power of independent checks, in order to assess compliance with established rules and regulations of the organization (Okoya, 2002).

According to Thompson (2003), internal auditing should not be restricted to financial transaction only. Internal auditors can equally assist management by ensuring that adequate financial and management controls have been implemented and are operating effectively or by identifying the weakness in such system and making recommendations toward their improvement. These include among others; internal audit with which errors are more likely to be discovered in their early stages. Existence of assets is verified so as to protect the assets of the company, errors in account can be correctedearly once detected by the internal auditors, its acts as moral influence on the staffs and promotes efficiency by compelling the officers to keep on their books of account entered up to date, a detailed examination of the financial account submitted by contractors is facilitated, cash disbursement, such as for wages and salaries, may be checked before theyare cashed.

The responsible for ensuring that internal control is established in the organization lies with management. The internal audit is supposed and to be custodian of internal control by providing assurance to the management that the company has put in place adequate and effective internal control system, and must not hesitate to draw management's attention to lapses observed in the control. A good and visible internal control system increases operational efficiency, thereby making it more difficult for the preparation of fraud (Mayo, 2003). Effective internal control requires; appropriate accounting procedure and system, division of duties I.e. separation of responsibilities, especially those of authorization, regular verification of supervision of each person's work by their superior officers. Internal control in its broad sense includes all controls operated by an organization to facilitate its activities and improve its efficiency and productivity. It also includes all administrative controls designed to effect, supervise and check management policies and strategies within an organization such as work study, production control, marketing, selling and distribution, financial and accounting control. The main objective of internal auditing is to provide assurance to management that the internal control system in the company is sound in design and effective in operation. It also helps to achieve value for money(Momoh 2005).

Okwoli (2004) also shares the view that the present requirement of internal audit is not the detection of fraud and errors, but reviewing the system of internal control. This is because in private company, internal audit is meant to carry out an independent appraisal of the effectiveness of internal controls and other financial controls in such ministry. Norm Anton as cited in Daniel (1999), emphasizes the importance of internal audit by saying that ''without audit, no efficiency, no development. The growth of any economy depends to a large extent on the system of control adopted by the management and the success and sustenance of the internal control lies on internal auditing. The above observation underscores the importance of internal audit in every organization of the internal control to effect.

Organization all round the world be it financial or otherwise needs auditing for proper assessment of their financial statements. In order to achieve set out goals and objectives, resources must be properly managed to get the profound results needed. (Joe, 2013).

Auditing in the Nigerian organizational system is relevant hence financial management in any company leads to the success and growth of the company.Auditing as a tool for accountability for efficient and effective company administration is clear term study which will educate us on the importance of company audit and how it will affect the staff if mismanagement of fraud eventually occurs.

**Statement of the Problem**

Fraud is the use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources or assets, and is unfortunately, much more common in private than some owners realize. It has really been the undoing of many unlucky businesses. Private companies are likely to be victims of internal fraud, even much more than their larger counterparts (conventional Companies) as owners tend to put blind faith in their employees. They also neglect to take proper precautionary measures against fraud, which can add to the cost of doing business. The problem is that the trust that many owners o private companies placed in their employees is not always justified.

Clearly, fraud is a pervasive corporate problem, affecting organizations across industries and sectors without regard to size. Because of fraud's disastrous consequences, failure to put deterrent procedures in place could put a company out of business within days. Fraud prevention, then, is a defined program of proactive measures to avoid or mitigate fraud. Failing to address these issues places a company at a competitive disadvantage when fraud becomes a cost of doing business. The study therefore, wants to ascertain how internal audit contribute to effective fraud control in organizations.

**Objectives of the Study**

The main objective of the study is to examine the internal audit system in the operation in companies in Nigeria and evaluate the effectiveness of the system as a toll for fraud control.

The study also has its specific objectives as follows:

To ascertain the contribution of internal audit in fraud prevention in a manufacturing organization.

To evaluate the contribution of internal audit in fraud detection in a manufacturing organization.

To evaluate the contribution of internal audit in fraud remediation in a manufacturing organization.

**Research Questions**

Based on the objectives, this study seeks to answer the following questions:

To what extent do internal audit contribute to fraud prevention in a manufacturing organization?

What is the contribution of internal audit to fraud detection in a manufacturing organization?

How does internal audit contribute to fraud remediation in a manufacturing organization?

**Research Hypotheses**

This study is required to test the following:

$H_0$: Internal audit does not contribute significantly to fraud prevention in a manufacturing organization.

$H_1$: Internal audit contributes significantly to fraud prevention in a manufacturing organization.

$H_0$: Internal audit does not contribute significantly to fraud detection in a manufacturing organization.

$H_1$: Internal audit contributes significantly to fraud detection in a manufacturing organization.

$H_0$: Internal audit does not contribute significantly to fraud remediation in a manufacturing organization.

$H_1$: Internal audit contributes significantly to fraud remediation in a manufacturing organization.

## 1.6 Significance of the study

The work is very relevant in one way or the other to the Nigeria companying industry as a whole, primarily this study is designed for all those who may be interested in carrying out further study on internal audit system as it related to fraud prevention, detection and remediation in manufacturing organizations in Nigeria.

**Manufacturing Companies:** companies in Nigeria will derive great assistance from this research work in detecting fraud in their companies and improving their internal control system subsequently preventing and minimizing fraud. There is no need over-emphasizing the fact that if companies are able to reduce the incidence of fraud in their operation to the least level, there will be able operates on a more profitable ground.

**Shareholders:** They are the direct beneficiary of companies and they will get bonuses if the companies operate successfully. The use of internal audit system will reduce the risk of fraud and increase the company's profit which will reflect on the dividends of the shareholders.

**Customers:** company customers deteriorating confidence on the companying industry will once more be restored and thereby help in building up good companying habit in Nigeria.

**Government:** The creation of an effective internal audit committee function can help a government establish accountability because it can focus specifically on issues related to fiscal accountability.

## Scope of the study

This study concentrates solely on the manufacturing organizations and focuses on Michelle Laboratory Plc.

Empirical generalization will be made of other private organizations in Nigeria.

## Limitations of study

A very detailed research work was not possible as a result of some limitations suffered by the work.

The major part of this is as a result of the secrecy of organizations in Nigeria. Organizations in Nigeria do not let out information to people easily especially researchers. This is because other people can make reference to their research work and use the information against the organization.

Other limitation composed on this study, is that of shortage of time and financial constraints. The time limit set for the submission of this project work was short and this made it impossible for a detailed research work to be carried out. These problems of time and finance account for the limitation of the sample size to only Michelle Laboratory Plc. in Enugu. However, through concerted effort I was able to finish the project without compromising the quality of output.

**Definition of terms**

It is very eminent to define some professional terms and language used in this work to make it easily understandable to interested readers of other disciplines.

**Audit:**Ajembi (1999) describe audit as an examination by an individual or a firm of a set of financial statement and to the underlying books and records which result, the auditing provides an opinion on the financial statement. Audit here refers to internal audit.

**Accountability:** This simply defined as the process of keeping and documenting all the relevant data of an event.

**Stewardship Account:** This is an account required of the stewards or agents to render to the person they are subjected to the management of a firm render stewardship account to the members of the boards of directors.

**Financial Statement:**this is a formal record of the financial activities and position of a business, person or other entity.

**Shareholders:** This is a person who owns a share in an organization or firm.

**Financial Irregularity:** This is the international distortion of the financial statement for whether purpose of misappropriation of fund.

**Compliance Audit:** This is a kind of audit method carried to ensure that all books and records are in agreement with the laid down procedures and regulations.