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Fraud Detection and Prevention Methods in the Malaysian Public Sector: Accountants' and Internal Auditors' Perceptions

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Abstract

This study aims to identify methods to detect and prevent fraud and corruption in the public sector in Malaysia and their corresponding perceived effectiveness from the accountants' point of view. This study uses structured questionnaires (Cates, 1985) on a population sample comprising accountants and internal auditors from the Malaysian public sector. The outcomes from the study showed operational audits, enhanced audit committees, improved internal controls, implementation of fraud reporting policy, staff rotation, fraud hotlines and forensic accountants are among the most effective fraud detection and prevention mechanisms employed in the public sector. This study contributes towards enhancing the scope and effectiveness of fraud and corruption detection and prevention in the government machinery in Malaysia.

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1. Introduction

It is necessary for an organization to establish an effective fraud prevention and detection method because it can reduce the opportunities of fraud from occurring (Bierstaker, Brody and Pacini, 2006). These methods can comprise managerial communications about intolerance to fraudulent activities, executing transparent performance and remuneration schemes, pre-employment and on-going screening and, most significantly encouraging a culture of

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fraud awareness (PwC, 2012). A survey conducted by PwC (2014) revealed that 37% of respondents globally reported fraud did occur in their organizations, and the number of economic crimes seemed to pose a persistent threat to businesses and their business processes. Ernst & Young (2014) reported the 59 countries involved in the survey agreed that incidence of fraud and reported cases are not declining. In fact new ways of fraud constantly emerge and matters that regulators and public consider inappropriate or fraudulent are evolving.

A survey by KPMG Malaysia (2013) discovered that the highest number of fraud perpetrators came from employees which represented about 50%. These employees were found to be among those in non-management. In 2009, this category of fraud perpetrators i.e. employees, in contrast, only represented about 34%. These figures are alarming to the government and the management, as there was an increase of 16% in 2013. The second category of fraud perpetrators were customers, followed by management, each category represented about 18% respectively. Other fraud perpetrators identified were service providers (8%) and suppliers (6%). The report also highlighted that theft of outgoing funds was the highest reported category of fraud at 67% in 2013 compared to 57% in 2009 survey. Ranking second, was theft of physical assets at 58%, followed by theft of incoming funds at 34%. On an individual basis, the most common types of fraud were theft of cash and cash receipts (26%), followed by false invoicing (16%) and theft of inventory (13%) (KPMG Malaysia, 2013). Governments and corporations as claimed by Ernst & Young (2014) agree that fraud, bribery and corruption are bad for business and society, and that decisive steps need to be taken to reduce them.

Fraud prevention calls for measures to stop fraud from occurring in the first place. Fraud detection comes next once fraud prevention has failed as it involves identifying fraud as quickly as possible once it has been perpetrated (Bolton and Hand, 2002). By nature, fraud detection must be used and worked continuously as fraud evolve. Clearly, the traditional approach to detect and prevent fraud, like auditing, is not sufficiently effective and only enabled fraud to be detected months after the date of the transactions, if ever. In some cases the consequent huge losses cause the organization to lose sustainability and the business would consequently collapse. Such belated discovery of fraud would then only have recourse on punishment which demonstrates a reactive approach instead of a proactive approach. Hence, deriving an understanding on the causes of fraud or economic crimes becomes vital, since this will crucially lead to identification of the most effective mechanisms to detect and prevent the occurrence of fraud.

Prior studies on fraud detection and prevention method have focused mainly on the private sector (Bierstaker, Brody and Pacini, 2006; Smith, 2012; Apostolou and Crumbley, 2008; Alleyne and Howard, 2005; Oluwagbemiga, 2010; Durtschi; Rahman and Anwar, 2014). There were limited studies conducted on fraud detection and prevention in the public sector. There are various audit procedures that can be applied to detect fraud in the public sector. Interestingly, most researchers discovered analytical procedures were the most effective method to detect fraud. Therefore, the objectives of this study are: (i) To identify public sector employees awareness of fraud, (ii) To examine the existence of fraud detection and prevention techniques in the public sector organizations; and (iii) to examine the usage of technology to detect and prevent fraud. The findings of this study provide insights into the awareness of fraud detection and prevention among the Malaysian public sector organizations.

The study is organized in five sections. Section two discusses extant studies on fraud detection and prevention methods. This is followed by research methodology. Subsequently, the findings of the study will be presented and finally conclusions will be drawn.

2. Literature Review

A survey of fraud awareness, prevention, and detection in the public sector conducted by PWC (2012) on behalf of the Auditor-General of New Zealand concluded internal control systems was the most effective instrument for detecting fraud, with 36% of respondents alerting frauds were detected by this method. The survey also found less than 1% of fraud occurrences were discovered by external auditors since detecting fraud is neither the determination nor the emphasis of an external audit. However, Apostolou and Crumbley (2008) observed both regulators and stakeholders are strengthening the role of auditor's deterrence and detection of fraud. They asserted the Public Company Accounting Oversight Board (PCAOB), AU section 316.52 discusses varying the nature, timing, and scope of auditing procedures required to address recognized risks of material misstatement attributable to fraud.

The Better Practice Guide prepared by the Australian National Audit Office and KPMG (2012) identified fraud prevention approaches are the primary line of defense and provide the most cost-effective method of controlling fraud within an entity. These include ethical organizational culture, high awareness of fraud among staff, vendors

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