

**EFFECT OF EMPLOYEE FRAUD MANAGEMENT PRACTICES ON FRAUD  
DETECTION IN SMALL AND MICRO ENTERPRISES IN MIGORI TOWN, KENYA**

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## **DECLARATION**

### **Student declaration**

I declare that this research work is my original work and has not been previously published or submitted elsewhere for award of a degree. I also declare that this contains no material written or published by other people except where due reference is made and author duly acknowledged.

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### **Supervisor's declaration**

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## **DEDICATION**

This work is dedicated to my family; my husband for always being there even when things were tough, my children for continued challenge and for their never ending support. Their support, encouragement and dedication have been priceless.

## ABSTRACT

Fraud in organizations is a major threat to performance. Specifically, employee fraud has been identified as a major form of fraud that occurs in companies and a subject that has received interest among researchers. This study aimed at investigating effect of employee fraud management practices on fraud detection in small and micro enterprises in Migori town, Kenya

the study aimed at achieving the following specific objectives including establishing how weak internal control system influences employee fraud in organizations, to determine how collusion between employees and third parties affects employee fraud in organizations and to examine the how whistle blower protection system influences employee fraud in organizations. This study adopted a descriptive survey design because it aims at giving an accurate description on the factors contributing to employee fraud in Kenyan organizations. The target population was 478 employees working in micro enterprise in Migori town. The researcher used a census survey as the sampling method. The sample of the study was 142 employees working in micro enterprise in Migori town. Questionnaires were used as the main data collection instrument. The research used primary data collected from the participants. A pilot testing was done to test the validity and reliability of the data collection instrument. Data analysis was done using the Statistical Package for Social Sciences (SPSS). The Cronbach's alpha was used to measure of internal consistency of the variables that is, how closely related a set of variable are as a group. Data was presented using percentages, frequencies, tables and figures. Before data collection, the researcher got authorisation from the university and consent from the respondents. The study concludes that internal control systems rest mostly influence employee fraud management, for a control system to be described as effective, control policies and procedures must not be under the influence of one person. When such a thing happens that individual can easily override the controls and the employee fraud increases. The study recommends that business owners should engage in training and for their employees on internal controls. They should be confident enough when it comes to controls because internal controls are vital to the success of a business. The business owners, amongst themselves in an area should organise workshops and seminars more frequently. This initiative would give them a platform to learn from each other about how to implement and follow the controls on fraud management. The study further recommends that incentives and appraisals should be given to employees who adhere to the internal controls and facilitate whistle blower system. Business owners should design the policies regarding internal controls which will act as a guide to follow internal controls. These policies should be easy to follow and should be changed every time there is a breach of internal controls. Systems for detecting problems faced businesses (embezzlement of records, and asset misappropriation) should be put in place so that any occurrence of such matters is reported immediately.

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## **ABBREVIATIONS AND ACRONYMS**

<b>ATM</b>	Automated Teller Machine
<b>CBN</b>	Central Bank of Nigeria
<b>CMA</b>	Capital Markets Authority
<b>FTC</b>	Federal Trade Commission
<b>PVA</b>	Polyvinyl Acetate
<b>SPSS</b>	Statistical Package for Social Sciences
<b>US</b>	United States

## DEFINITION OF OPERATIONAL TERMS

***Fraud:*** Fraud is a form of deception. It is intentionally using deceit, trick or other dishonest ways to deprive others of their money, property or legal right (David & Wolfe, 2004). Fraudulent actions involve elements of intentional false representation, which is acted upon the victim to the victim's damage (Albrecht, Kranacher & Albrecht, 2010).

***Misappropriation of assets:*** It is theft or the act of misusing the assets of an organization (Rezaee, 2010).

***Corruption:*** It is wrongly using one's influence in business or any other position for the purpose of procuring benefits for oneself contrary to what is expected of one's responsibility by the employer or the rights of others (Ruedy & Schweitzer, 2010).

***Fraudulent Statement:*** It involves falsifying the financial statements of a company by intentionally misstating specific financial values to make them appear profitable and in a better than the true financial position (Rezaee, 2010).

**SMEs:** These are small businesses with an annual turnover between Kenya shillings five hundred thousand and Five million (Njuguna, 2013).

## **CHAPTER ONE**

### **INTRODUCTION**

#### **1.1 Background of the Study**

Fraud is a practice that is not to be trusted, deceitful, dishonest or immoral. Fraud is the intentional, deliberate act to obtain unjust advantage Kula, Yilmaz, Kaynar, & Kaymaz (2011). For fraud to be present there needs to be a wrongdoer, a victim and a nonexistence of control or safeguards. Brody (2010) states that within occupational fraud, there are three categories: asset misappropriation, corruption and fraudulent statements. A huge size of employees in any organization is honest and straightforward. Though, businesses are currently establishing to realize and recognize the level of the danger created by the small percentage of employees who act fraudulently and deceive their company.

There is no question that financial fraud is a pressing concern. With billions of dollars in losses impacting on estimated tens of millions of victims, fraud is a major problem (Anderson, 2013). But the wide range of fraud prevalence estimates makes it difficult for organizations to assess the true scope and impact of the problem. Fraudulent activities in companies are experienced all over the world. A report done by the Federal Bureau of Investigation in the US stated that the most common fraudulent activities in organizations relate to computer fraud (Rennison and Rand, 2007 cited in Addington, 2008). The most recent Federal Trade Commission (FTC) survey of fraud in organizations estimated that 37.8 million incidents of fraud took place in 2011 (Anderson, 2013). Yet the FTC Consumer Sentinel Network, the database of consumer complaints, received just over 1 million organization fraud-related complaints in 2011 (FTC, 2013). According to a 2007 report of 30 countries in organization fraud, over one in ten companies have on average been a victim of fraudulent activities in the past year. Greece and Bulgaria each had unusually high rates of over 20%, and Japan had the unusually low rate of 2%. With a victimization rate of 12.5%, the United States had higher fraud prevalence than the international average.

In the Kenyan situation, there is increasing cases of fraudulent activities in most organizations within the country (Nichols, Bruguier and Marcos, 2006). The case of fraud in majority of these organizations is related to lack of personal finance discipline of individual employees working in these organizations. Garman, Leech and Grable, (1996) argue that personal finance behavior of employees if not positive and leads to employee stress related challenges. They purport that when employees have poor personal financial discipline, they fall pray of fraud attempts. Organizations have been faced with a lot of fraudulent activities ranging from their own staff moving funds internally to their own accounts and in some cases, staff moving funds to offshore accounts.

The latest trend has advanced and some of these staff colludes with customers to defraud companies. Many businesses are increasingly losing funds through staff instigated fraud (KPMG, 2003). This happens through collusion by staff and customers and only 60% of such fraud is reported since they try to prevent negative publicity by attempting to deal with such disciplinary cases internally. Although studies have been generally conducted about fraud, in organizations, a direct linkage of study which has attempted to relate influencing factors in the context of the private sector in Kenya has not been done. These organizations continue to suffer as a result of the fraudulent activities surrounding the (Cheptumo, 2010). Placing fraud in the private sector in Kenya will help us understand the current factors influencing fraud in these institutions and provide a direction for how accuracy of reporting and measurement can be improved in the future. This study wishes to shed more light on the factors influencing employee fraud in private organizations.

### **1.1.1 Micro Enterprises in Kenya**

Micro enterprise in Kenya predominantly prevail upcoming towns while medium and large-scale enterprises dominate bigger towns and cities. The micro enterprise sector is particularly important for low-income groups. In Kenya, like in any other developing countries, medium and large-scale manufacturing or service giving sectors due to state bureaucracies could not create enough jobs to absorb the ever increasing labor force, especially in urban areas. In such situations, micro enterprises may be reported to be source of livelihood for poor and unemployed people in both urban and rural areas (Fantahun, 2010).

To the individual they provide employment and raise the standard of living of both employers and employees. To the nation, they complement large scale modern sector enterprises, they utilize agricultural and other raw materials that would have gone to waste, they serve limited or closed markets that warrant only small scale production, they mobilize resources otherwise left out of the mainstream formal mobilization channels and they provide the necessary platform for take-off into large scale modern production by many indigenous Kenyans (Bwisa, 2011). SMEs are the main source of employment in developed and developing countries comprising of over 90% of African business operations and contributing to over 50% of African employment and GDP (Okafor, 2006). The small and micro Enterprises play an important role in the Kenyan Economy. According to the economic survey (2006), the sector contributed over 50 per cent of new jobs created in the year 2005. While the contributions of small businesses to development are generally acknowledged, SME entrepreneurs face many obstacles that limit their long term survival and development. Research on small business development has shown that the rate of failure in developing countries is higher than in the developed world and fraud management is one of the impediments of growth of these firms (Arinaitwe, 2012). Past statistics indicate that three out of five businesses fail within the first few months of operation (Kenya National Bureau of Statistics, 2007). Lacks of planning, improper financing and poor fraud management have been cited as the main causes of failure of small enterprises (Longenecker, 2010). Regardless of the high failure rate by SMEs in Kenya, their enormous contribution to the entire economy cannot be overlooked (Mbogo, 2011).

### **1.1.2 Concept of Employee Fraud**

Fraud occurs within the financial system of a company. Huge sums of money are lost with the parties involved grapple with different incidents of stealing company's money. According to DiNapoli (2007), four elements are involved when an employee is committing fraud including, a need, the opportunity, and rationalization within the mind of the fraudsters, low chance of getting caught as well as justification that the results will be achieved from the rationalization. When talking of fraud, it must exhibit three drivers that are described in the fraud triangle. Kassem & Higson (2012) state that opportunity and capability are elements in

the fraud triangle that demonstrates how people involved in fraud are influenced by their stay in the organization. In fact, employees who have already stayed for a long time in the organization usually are found to have gained trust within these companies. These people also understand better the organization controls regarding fraud. Therefore, it is easy for them to maneuver and get ways of undertaking fraud while concealing it capacity to be noticed. Employees having worked in the organization for many years have probably operated in almost all departments. All over these years, the employees have been promoted to different ranks and other employees start reporting to them. Their position does not warrant the other staffs questions their integrity or his actions. These are circumstances that create opportunity for such an employee to commit fraud even in the slightest event they may find possible to do so. They are events that can be compared to leaving the safe unlocked because of trusting a person. These opens doors are the opportunities for the person to carry out fraudulent activities.

Motivation and pressure are other elements that drive employee fraud in an organization. For example, an employee with financial problems, divorced or relationship difficulties that are driven by financial factors will most likely commit fraud to take care of these problems. In fact these are circumstances that create a lot of pressure among employees to look for alternative methods of raising income. Like any other crime, fraud usually needs motivation such as greed, financial difficulty or even financial need to enrich oneself (Greve, Palmer and Pozner, 2010). The rationale behind fraud is another driver of why employees commit such actions of betrayal to their organizations. Fraudsters just like other types of criminals will always give a rationale for their actions. For example, a long serving employee may get even with the organization and overlook the person in searching for a better candidate. Additionally, employees having served the organization for a long term may feel that they are superior and can play around with the company rules (Chirasha and Mahapa, 2012).

Even though the drivers of fraud may be considered theoretical, they actually happen and have been evidenced in organizations all over the world. However, the opportunity to commit fraud by employees will depend of the type of an organization and the effectiveness of the whistle blow system (Robinson, Robertson and Curtis, 2012). Therefore, it is

important for organizations to be vigilant enough in ensuring that its controls are tight as well as the oversight is competent enough for the purpose of identifying events that may lead to occurrence of such events. Brytting, Minogue and Morino (2011) states that being able to recognize the drivers of fraud is a good starting point that can help organizations in reducing fraud incidences. Even though assignment and internal controls are good, it is crucial for organization to recognize that they are dealing with human elements as a measure that can help in preventing the occurrence of fraud. With primary focus on financial statement fraud, internal auditors are capability of detecting fraud occurring in an organization (Wyk, 2013).

Organizations frequently do not desire to confess that their employees are stealing from them, yet they know that many try to and a few make it. Most organizations prefer to absorb losses which eventually become very costly in the long run (Raczkowski and Schneider, 2013). The deceitful behaviors of employees are the main reasons of losses in organizations. Poor business performances and inadequate supervision generate an atmosphere for fraudulent workers to utilize a range of means to embezzle from their employers. Reported fraud cases only represent the tip of the iceberg.

## **1.2 Statement of the Problem**

Several companies have faced employee fraud despite the fact that management has attempted to motivate employees to their best of ability to ensure employee loyalty. This is a problem faced by large companies alone as it happens in small companies as well (Isa, 2009). The only difference between what happens in large companies as opposed to small companies is the publicity that may follow the act. In well established organization, employee fraud may be reported in the media due to the serious impact that the act can have on the company. Some of the companies that have been faced with employee fraud include imperial bank, Trust bank, Mumias Sugar (Njugun, 2013). The company's reputation was negatively affected in the Mumias Scam, the standard newspaper indicated that there was leakage of tax payers money through Mumias company (Standard, 2015). Reputable companies like Enron, WorldCom in the US and also Trade Bank and Euro Banks in Kenya collapsed due to employee fraud (Gottschalk, 2011).

Employee fraud may be caused by a number of factors which include lack of motivation, poor remuneration, poor and working conditions. Armed with this knowledge (Wyk, 2015), managers have attempted to generate strategies to reduce losses that may be caused partly through employee fraud. Examples of these strategies are good employee remuneration as well as other incentives which are expected to boost employee loyalty and commitment for the firm's growth and development (Kassem, 2012). Employee fraud can have differing impacts on the success of a business and in most serious of cases it can lead to business failure and destroyed careers (Kula, 2011). Good employees do not want to work for a business where fraud is widespread, not investigated or not acted upon. The reputation of the business in the eyes of suppliers, customers, competitors, possible employees and other business partners (for example banks) can be damaged. Businesses may become overly internally focused in response to a fraud. For individuals that supervised the fraudster, the fraud can impact their reputation and therefore their career, particularly if the manager is in a financial role, as others will expect that given their expertise, they should have prevented the fraud (Lari, 2009).

Various studies have been done in relation to fraud in organizations. Raezaee (2005) studied about the causes, consequences and deterrence of financial statement fraud in US organizations. The findings revealed that several interactive factors influence fraud occurrence, detection and prevention in organization. Zahra, Priem & Rasheed (2005) did a study in relation fraud and the top management of a company and its consequences. The finding of the research showed that senior executives in a company engage in fraud due to individual differences and personal interests. This fraud have consequences on shareholders, society and debt holders. In their study, Bryan and Smith (2005) evaluated the prevention and perpetrator aspects of employee fraud in organizations and found out that financial reporting issues are the main perpetrator of employee fraud.

Even though there are many studies on fraud, it is clear that little or no studies have been done on factors contributing to employee fraud in Kenyan private organizations. Yet, past studies have also not touched the influence of internal controls as a factor that contributes to employee fraud in organizations. Besides, the studies on whistle blowing do not touch the



part of employees in raising the red flag when they have information about the possibilities of fraud in the organization. The knowledge and research gap in these areas is what this study aims at filling. Therefore, this study aims at investigating determinants of employee fraud management in small and micro enterprises in Migori town, Kenya.

### **1.3 Objectives of the Study**

The main aim of the study is to establish employee fraud management practices on fraud detection in small and micro enterprises in Migori town, Kenya. The study aims at achieving the following specific objectives;

**Level of efficiency of the Internal Control System; Checks on employees-third party collusion**

- i. To establish the effect of level of efficiency of the internal control system on employee fraud detection in micro enterprises.
- ii. To determine the effect of checks on employees-third party collusion on employee fraud detection in micro enterprises.
- iii. To examine the effect of whistle blower protection practice on employee fraud management in micro enterprises

### **1.4 Research Questions**

- i. To what extent does level of efficiency of the internal control system contribute to employee fraud management in micro enterprises?
- ii. To what extent does checks on employees-third party collusion contribute to employee fraud management in micro enterprises?
- iii. To what extent does the whistle blower protection practice contribute to employee fraud management in micro enterprises?

### **1.5 Justification of the Study**

Employee fraud is common in many organizations in Kenya and the whole world. Companies have incurred huge losses resulting from employee fraud. The effects of fraud to companies are a primary objective why those organizations must take steps to reduce employee fraud. With the many tactics that employees are facing, organizations are called upon to be more careful with the internal controls and any whistle blows about fraud. They should also take the precautions of installing effective measures that can easily detect employee fraud fast without leaving the company at the exposure of incurring many losses in the long term. Failure of taking such measures is a threat to a company's profitability and performance whereby employees are taking the advantage of the weak systems of internal controls and carry out fraudulent acts that lead to incurring of huge losses for companies. This is why the study seeks to investigate determinants of employee fraud management in small and micro-enterprises in Kenya.

### **1.6 Significance of the Study**

The study would be of significance to organizations in the sense that they can use the information provided so as to understand areas that need to be monitored in reducing employee fraud. Company managers can use the information provided in this study to understand the major causes of fraud from employees. This is a step towards initiating ways of preventing employee fraud from occurring.

As whistle blowers, employees would benefit from this study because it offers information on how the workers can encourage a protected whistle blower system that ensures their protection after raising the red flags of fraud. An employee's understanding of the company's system of internal controls is extremely important for deterring fraudulent activities. The study would act as an education source material for employees on how to recognize fraud and the detrimental effects that it can have on an organization. Employee whistle blowing is the only way to detect occupational fraud. Anti-fraud training programs for employees, managers and executives organizations reduce losses and shorter-term frauds than organizations lacking such programs in place.

The study would also be beneficial to future researchers who would like to extend their investigations on this topic of factors influencing employee fraud management in organizations. This study would act as a baseline research that can give them a guide on areas that require further study concerning the topic. The ideas provided in this paper can give them an understanding of what it all entails in employee fraud and detection.

### **1.7 Scope of the Study**

The aim of the research was to analyze determinants of employee fraud management in micro and small enterprises in Migori town, Kenya. The study would be carried out in Migori and focused on a cross section of employees in various Micro and small enterprises in Migori County.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

This chapter presents the research's theoretical framework, empirical review of related past studies, critical evaluation of related literature and research gap and the research's conceptual framework.

#### **2.2 Theoretical Framework**

Research has shown that any problem in an employee's life will affect their psychological wellbeing and mental state at work (Garman, 1998). Joo, (1998) and Glassman, (1998) noted that employee personal finance education can reduce employee theft and limit exposure to litigation. According to Wells (2001), no employee joins an occupation with the sole purpose of committing fraud. He however wonders how good people go bad to the extent of committing fraud. To him, an obvious answer is greed. There are two theories about why employees commit fraud. The study is based on two theories namely: the fraud triangle and agency theory.

##### **2.2.1 Fraud Triangle Theory**

This theory was put forward by Cressey (1953), who developed the fraud triangle model. The theory posits that for fraud to be successful, three things must be present namely opportunity, pressure and rationalization (Njuguna, 2013). The term fraud has been defined in different ways by different authors. According to Bejarano (2008) fraud is described as any premeditated act of criminal deceit, trickery or falsification by a person or group of persons to obtain undue personal monetary advantage. Studies have concluded that the most common reason employees committed fraud are opportunity driven by motivation where the more dissatisfied the employee is, the more likely they will engage in criminal activities at place of work.

Employees may commit fraud due to financial pressures. Cressey (1953) interviewed nearly 200 incarcerated embezzlers, including convicted executives. He found the great majority committed fraud to meet their financial obligations. Cressey (1953), observed that two other factors had to be present for employees to commit fraud. They must perceive an opportunity to commit and conceal their crimes, and be able to rationalize their offenses as something other than criminal activity (Wells, 2007). The working environment has proved to be a cause of fraud as it contributes to the cost of living. Employees colluding with each or with third parties to steal funds from the business will be causing fraud.

People working in hardship conditions and are on low pay yet are exposed to shareholders funds at their disposal tend to be encouraged to commit fraud as opposed to people living in environments where cost of living is low. It means that the internal control system in the company is weak. Theorists in the twentieth century believed crime was the result of the environment or that crime was symptomatic of an emotional disorder (Nyaoke, 2007).

According to Basel Committee, (2011) companies need to reconcile all accounts that could contain a significant or material misstatement and post all necessary adjustments to the general ledger in a timely manner. Necessary adjustments include all identified general ledger entries that either individually or in the aggregate are significant or material to the financial statements, with the most necessary adjustments being those that would result in a material misstatement if they were not recorded. The company also should analyze all unreconciled accounts and unposted identified adjustments to the 15 general ledger to determine their effect and the potential for financial misstatement or significant deficiency or material weakness.

Detecting fraud early enough helps to minimize losses and increases the likelihood of recovery for frauds that have been identified. Putting detection measures in place can also act as a deterrent, preventing potential frauds from being committed and making the organization more resilient to fraud hence the theory is relevant to the study.

### **2.2.2 Agency Theory**

The theory describes risk-sharing as the problem that arises when cooperating parties have different attitude towards risk whereas agency problem occurs when cooperating parties have different goals and division of labour. Agency theory describes the relationship between the cooperating parties who are the principal and agent by resolving two problems; the desires or goals of the principle and agent conflict and the difficulties of principal in verifying agent behavior appropriately and efficiently (Wanemba, 2010).

The unit of analysis in agency theory is the contract governing the relationship between the principal and agent. The theory focused on determining the most effective contract given the assumption about people, organization and information. The main aim is to determine behavior oriented contracts are more efficient than outcome oriented contracts. Agency theory has developed based on contracts and has proved to be effective in curbing agent opportunism. This theory focuses on the relationship between principals and agents who exercise authority on behalf of institutions (Wells, 2001).

This theory postulates that principals have to solve two primary tasks in choosing and controlling their agents: one, they have to identify the best agents and create motivations for them to behave as required; Two, they have to appraise and consistently monitor the behaviour of their agents so as to ensure that they are actually performing as agreed (Albrecht, 2008). Agency theory is seen to be a regulator of employee's behavior when it comes to useful management of the organization finances. It therefore acts as a deterrent to instances of abuse by the employees as they are basically custodians of the finances and not owners of the shareholder's wealth. This therefore calls for the employees with access of a company's money and financial information to be good caretakers and not embezzlers of these funds. Employees are subjects working for the principal, meaning that they must be prudent enough to produce the best for the company/principal.

Agency problems could also occur due to the existence of inefficiency in the board or its audit committee. This will lead to senior management being a powerful influence over the

internal audit which eventually creates an inherent dilemma for the internal audit department leading to the failure of the internal audit systems. Internal auditors, as much as they are employs of senior management, are also agents of the board and audit committee. However, their varying motives may lead to their actions being against the board of directors' interests and its audit committee. These motives include financial rewards from managers, personal relationships with them, and the power of senior management in shaping the future position of internal auditors and their salaries. This leads to cover up on employee fraud and acts a great hindrance on employee fraud management (Robinson, 2012).

Agency theory also informs the study It is therefore paramount that the Internal auditors as agents perform audit processes at the professional level requiring education and professional certifications, experience, and other competencies needed to perform their responsibilities perfectly. Internal audit personnel with such requirements and the existence of training programs would increase the confidence level in their advice on the installation and eventual use of internal control systems in among other roles, effective fraud management (Hanefah & Endaya, 2013)

### **2.2.3 The Fraud Management Lifecycle**

Effective management of the fraud management lifecycle starts with a common understanding of the stages in the lifecycle (Wilhelm, 2004). The fraud management lifecycle is a network lifecycle where each stage in the life cycle is an aggregated entity that is made up of interrelated, interdependent and independent actions, functions and operations (Albrecht et al., 2009). The fraud management lifecycle is made up of eight stages; Deterrence stage involves stopping fraud before it happens by increasing the difficulty of committing the fraud as fraudsters tend to migrate tend to migrate toward the path of most anonymity and least resistance (Wilhelm, 2004).

Deterrence is achieved through creating fear of consequences or difficulty of perpetration, to turn aside, discourage or prevent fraudulent activity from being attempted (Kimani, 2011). Policy must seek to balance deterrent value, loss reduction, sales volume, operational scalability and cost effectiveness (Wright, 2007). Policy development involves constantly

reassembling the situations disassembled in the analysis stage, by taking advantage of the knowledge gained by analysis, combining it with internal, external and interactive environmental factors in order to craft policies that address the whole, while leveraging the knowledge of the parts (Wilhelm, 2004). Policy development staffs are most frequently the leaders within the fraud management organization as they must consider all disciplines within the fraud management department as well as the needs of the rest of the business enterprise (Hassink et al., 2010). The investigation stage involves obtaining enough evidence and information to stop fraudulent activity, to obtain recovery of assets or restitution and to provide information and support for the successful prosecution and conviction of the fraudsters (Albrecht, et al., 2009).

Fraud investigations are focused upon three primary areas of activity; internal investigations, external investigations and law enforcement coordination. Internal investigations includes investigations of employees, contractors, consultants or vendors while external investigations are conducted on customers, fraudsters and organized groups (Wilhelm, 2004). Law enforcement coordination as further argued by Gottschalk (2010) is the provision of information and resources to, and the maintenance of, a partnership with federal, state, regional and local law enforcement authorities. Rigorous and routine investigations provide for both an incremental lift in deterrence and the maintenance of an effective relationship with law enforcement. Finally the prosecution stage is focused upon prosecutorial and judicial authorities as well as with law enforcement (Wilhelm, 2004).

The three aims of prosecution in the fraud arena is to punish the fraudster in an attempt to prevent further theft, to establish, maintain and enhance the business enterprise's reputation of deterring fraud so that the fraud community becomes aware of it and to obtain recovery or restitution wherever possible (Albrecht et al., 2009).

Rigorous and routine investigations provide for both an incremental lift in deterrence and the maintenance of an effective relationship with law enforcement. Finally the prosecution stage is focused upon prosecutorial and judicial authorities as well as with law enforcement (Wilhelm, 2004). The three aims of prosecution in the fraud arena is to punish the fraudster



in an attempt to prevent further theft, to establish, maintain and enhance the business enterprise's reputation of deterring fraud so that the fraud community becomes aware of it and to obtain recovery or restitution wherever possible (Albrecht et al., 2009).

### **2.3 Empirical Review on Related Studies**

This section presents review of related literature from past studies on employee fraud in organizations, weak internal control system, collusion between employees and third parties and ineffectiveness of whistle blower protection system. There are various studies which have been conducted in accounting and finance fields in relation to fraud.

#### **2.3.1 Internal Control Systems and Business Fraud Management**

According to Idowu (2009), internal controls in an organization have been described as good measures of preventing fraud and especially on the part of employees. Abiola and Oyewole (2013) did a study to investigate the internal control system on fraud detection in Nigeria. The results revealed that internal Control System has been the most single trusted and effective measures that can combat this act of malpractices to the barest minimum. In fact, the Central Bank of Nigeria (CBN) reported that the backward development in Nigeria was attributable to the weakness in the Internal Control System of the banks (Central Bank of Nigeria, 2005). Therefore, an attempt to bring to the barest minimum if not to completely eradicate the spate of fraud is effectively dealing with it by the measure of an internal control system.

In the work of Olaniyi (2008), and aligning it with the findings made in the works of Fakunle (2006), Robertson (1996) and also in the work of Hamby (1998); employee fraud, according to him are now becoming a global phenomenon. The aftermath of fraud causes an embarrassment to the nation and on organization owners, customers and their family members, as most company failures are associated with large scale frauds. The emphases are that internal control department/unit of any organization is very important in detection and prevention of fraud and cannot be undermined. Since the lack of an effective internal control system is the major cause of organization frauds (Nwaze, 2011). It is then concluded that the management of every company should create and establish a standard internal control

system, strong enough to stand against the wiles of fraud in order to promote continuity of operations and to ensure the liquidity, solvency and going concern concept of the organization.

In his article about bank fraud in Nigeria; underlying causes, effect and possible remedies, Esoghene (2010) emphasized on the impact of external auditor in assessing a bank internal control system through their roles and responsibilities. Although external auditors are not part of the organization's internal control system, they have an important impact on the quality of internal controls through their audit activities, including discussions with management and recommendations for improvement to internal controls. Russell & Norvig (2003) studied about the artificial intelligence and fraud detection and found out that the external auditors provide important feedback on the effectiveness of the internal control system. While the primary purpose of the external audit function is to give an opinion on the annual accounts of the company, the external auditor must choose whether to rely on the effectiveness of the company's internal control system. The realization of a weak internal control system shows that the company has a high susceptibility to fraud. For this reason, the external auditors have to obtain an understanding of the internal control system in order to assess the extent to which they can rely on the system in determining the nature, timing and scope of their own audit procedures (Wyk, 2013).

In some countries, external auditors are required by the supervisory authorities to provide a specific assessment of the scope, adequacy and effectiveness of an organization's internal control system, including the internal audit system. A study done by Olufunso (2013) noted that one consistency among countries is the expectation that external auditors will gain an understanding of an organization's internal control process to the extent that it relates to the accuracy of the financial statements. Benjamin (2001) added that material weaknesses identified by the auditors are reported to management in confidential management letters and a recommendation for its improvement since it poses a threat to the organization through the possibility of employee fraud. Furthermore, in many countries external auditors

may be subject to special supervisory requirements that specify the way that they evaluate and report on weak internal controls found in organizations.

*H<sub>01</sub> – level of efficiency of the internal control system does not have a significant effect on employee fraud management*

### **2.3.2 Checks on Employees-Third Party Collusion and Employee Fraud Management**

From the top executives, management and lower level staffs, workers in organizations have been identified to deceive stockholders. Employees who carry out fraud in organizations will do so by colluding with fellow employees and third parties. Balogun et al., (2013) says that collusion of employees to cause fraud and often involves the manipulation of the records and the accounts, typically by the enterprises senior officers with a view to benefiting in some indirect way. Employees collude with each other to obtain finances under false presences or concealing a material, and worsening off the company's true position. According to KPMG (2003), collusion of employees and third parties is a deliberate fraud, committed by employees that injure investors and creditors, through materially misleading financial statements. Such fraud is usually perpetrated by the management staff of an organization.

DiNapoli (2007) carried out a study to find out how employee fraud occurs in an organization. He found out that the employee may work alone or they may work in collusion with a third party. Sometimes the latter occurs in what is known as a pass-through fraud whereby, an employee inserts their own intermediary company between a supplier of legitimate services and their employer (Murphy and Dacin, 2011). Payments are made for services but the employee's intermediary company skims a percentage of the transactions. They also re-submit a legitimate vendor's invoice for payment but using a bank account under the employee's control. To carry out this fraud, the employee usually has to gain access to the employer's accounting software whereby they are able to change the vendor's bank account to one under the employee's control to receive the payment (Deevy & Beals, 2013). To avoid detection the employee will then change the bank account number back to

the vendor's once the payment has been made and then pay the legitimate invoice again to the real supplier's bank account.

Red Flags in Payroll that show up in payroll are generally worthy of looking into to establish fraud through collusion between employees (DiNapoli, 2007). Although payroll is usually an automated function, it is a vulnerable area, especially if collusion is involved. Items that auditors should check include inconsistent overtime hours for a cost center, overtime charged during a slack period, overtime charged for employees who normally would not have overtime wages, budget variations for payroll by cost center, employees with duplicate Social Security numbers, names, and addresses and employees with few or no payroll deductions. Employees will collude with third parties by increasing vendor invoices (DiNapoli, 2007). As such employees and collusion between employees and third parties can all contribute to the occurrence of fraud in the workplace.

The elements that will further show collusion between employees and third parties are reluctance to provide information to investors and auditors, management decisions are dominated by an individual or small group, lack of segregation of duties, refusal to take vacation or sick leave and photocopied or missing documents (Green Hasson & Janks, 2012). Employee fraud through collusion of workers between themselves and third parties involve the participants ignoring evidence of excess income that would disqualify an individual. Such collusions need detection by the employee oversight by screening as well as training of staffs within the company. Collusion of employees between themselves and third parties also involves the creation of phantom participants to obtain benefits, theft of instruments or personalize instruments intended for particular participants (Deevy & Beals, 2013). Employees will also collude to deliberately misinterpret financial reports with the aim of carrying out fraudulent activities in the company. These vulnerabilities to employee fraud need early detection to ensure the company does not lose finances due to fraudulent workers. The KPMG (2003) noted that organizations identify collusion between employees and third parties as the most significant factor contributing to fraud. This combined internal

and external threat offers ample opportunity for improvement, and should be a focus of new anti-fraud programs.

*H<sub>02</sub> – Checks on employees-third party collusion does not have a significant effect on employee fraud management*

### **2.3.3 Whistle blower Protection System and Employee Fraud Management**

Whistle blower protection system plays a huge role in preventing the exposure of staffs who report fraud cases or impending cases of fraudulent activities in the organization. Employees with critical information about fraud in the organization need protection after disclosing any misbehavior by the management or fellow employees that may lead to fraud (Ayagre and Aidoo-Buameh, 2014). However, employees with important information about fraud in an organization face various problems as a result of disclosing their knowledge. It calls for the question of how effective the whistle blower protection system is to ensure the safety of employees with vital information that can help in mitigating fraud within the business. The duty of loyalty by employees requires that they do everything that benefits their employers as well as the organization (Ye, 2011). Whistleblowing makes the employees disclose information about managers and other executive directors intending to or undertaking fraud activities. These are their employers who they owe duty of loyalty.

The whistle blower system in organizations is usually ineffective because employees will be risking of retaliation that will be taken by their employers. Ratley (2016) says that many of the employees fail to disclose fraud behaviors and activities for the fear of termination, demotion, harassment by coworkers, the denial of advancement as well as other ways of discrimination. The ineffectiveness of the whistle blower system will contribute to employee fraud since staffs know that fellow employees will not report the incidences of fraudulent activities that they commit. The traditional values held by employers in organizations diminish the autonomy of employees to disclose any information that may help in establishing fraud.

The whistle blower system is ineffective and employees who try exposing fraudulent activities in an organization get threats from employers who assert that expelling is an inevitable means to keep employees loyal (Ye, 2011). The internal supervising systems and procedures to work and reduce the likelihood that employers would be blamed by the public because of whistle blowers limits employee's capacity to whistle blow. Isa (2009) says that bearing the threat of being retaliated against by employers, whistleblowing employees are also alienated by colleagues, and feel a lonely existence in the workplace. The history of whistle blowers, most of who have been fired, blackballed from their industry or profession, and has suffered personal problems. These personal problems include unaffordable legal expenses that employees spend against employers. Also, those involve misfortunes of loss of homes and marriages (Ye, 2011).

Ayagre and Aidoo-Buameh (2014) found out that because of a high possibility to be blacklisted in professional areas, whistleblowing employees may find it difficult to seek other occupations after being terminated since prospective employers might be afraid of hiring discharged employees due to their disloyal records to previous employers. The ineffectiveness of the whistle blower system in organizations will definitely increase fraud activities occurring through the management and employees since no one is willing to disclose such information even with the knowledge about it.

H<sub>03</sub>– Whistle blower protection systems does not have significant effect employee fraud management

## **2.4 Critical Analysis of Related Literature and Research Gap**

Empirical evidence on the factors contributing to employee fraud in organizations depicts mixed results, and in some case, it is inconclusive. According to the Fraud Survey of 2003, collusion among employees and between employees and third parties is a major cause of fraud in organizations. In another study, Ye (2011) says that employees with the knowledge of fraudulent activities cannot report them because of the fear of revenge from employers. These two studies conflict regarding the findings that are not clear and how they relate in explaining fraud. On one hand, employees are performing fraud while on the other hand;

they do not have the capacity to report fraudulent activities. It is not clear what employees should choose in achieving the best interests of the company.

Furthermore, the study by Ogbu (2008) is not conclusive on how fraud causes embarrassment to the nation as well as organization owners, customers and family members. The researcher did not explain how employee fraud in organizations occurs in large scale. Besides, many of the local and international studies focus on employee fraud in the banking industry. There is no single study discussing fraud caused by employees in other organizations such as private and public firms. For example all studies done locally by Lari (2009), Cheptumo (2010), and Wanemba (2010) were on fraud in the financial sector that experiences high fraud rates through misappropriation of bank's finances by managers. It means that despite the theoretical underpinnings and advocacy for minimization of fraud in organizations, there is scarcity of local data regarding the major variables of the study.

It is against this backdrop that the increasing support of detecting fraud in organization particularly in Kenya is sought. Employee fraud and the contributing factors are of high importance in predicting the areas of failure by employers and the management in organizations. It is a topic that requires a closer look in the face of limited empirical evidence to support the theoretically based factors attributed to employee fraud in Kenya. Thus the question is, how does weakness of the internal control system, collusion between employees and third parties and ineffectiveness of the whistle blower system contribute to employee fraud in organizations?

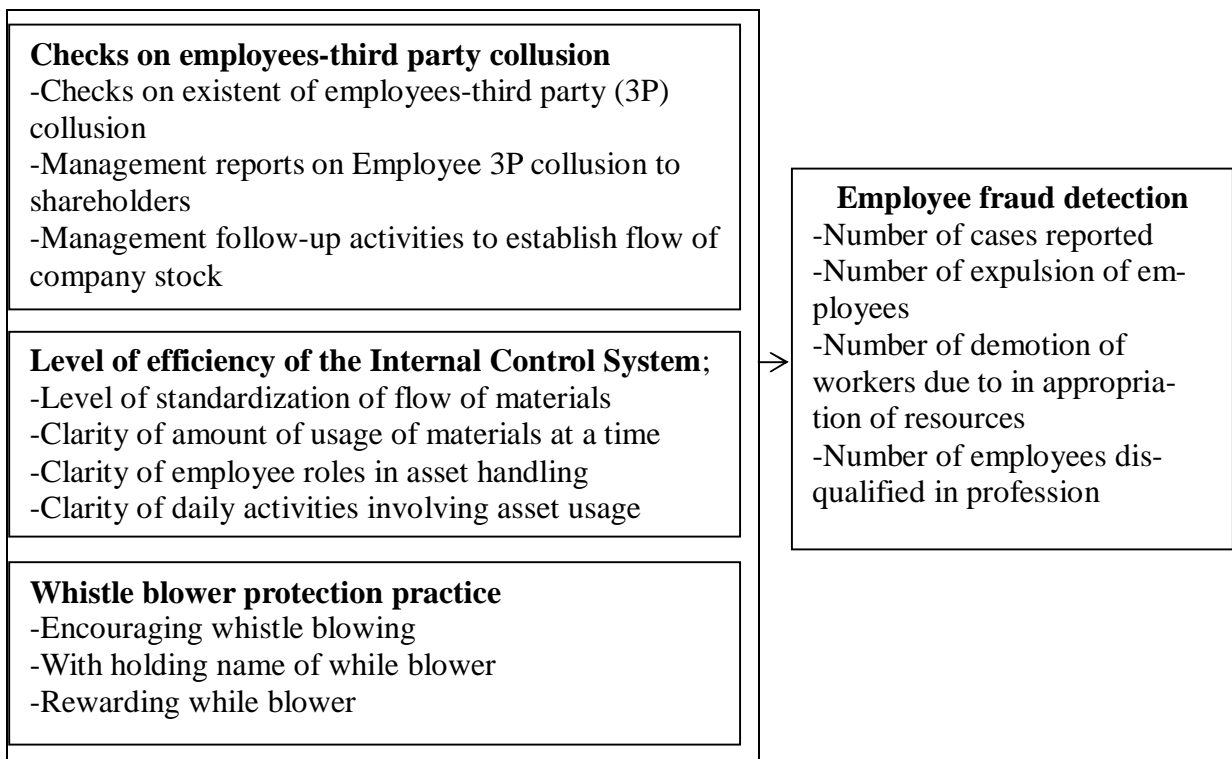
## **2.5 Conceptual Framework**

To carry out this inquiry, the study assumes the argument that weakness of the internal control system, collusion between employees and third parties as well as ineffectiveness of the whistle blower system contribute to fraud in organizations. Employee fraud in organizations is contributed by weak internal control systems that fail to detect fraudulent activities when they happen within the organization. A weak internal control system will contribute to employee fraud because of not having a standard internal control system, not strong stand against the wiles of fraud. The collusion among employees in the workplaces as well as between employees and third parties create ways of employees defrauding the

company not willing to provide information to investors and auditors, management decisions dominated by an individual or small group, lack of segregation of duties, refusal to take vacation or sick leave and photocopied or missing documents. The ineffectiveness of the whistle blower system contributes to the chances of employee fraud by reducing the employee's capability to reports instances of fraud within the organization. Employees have fear of expulsion or demotion by their employers that's why they fail to exposure the fraud behaviors of the fellow employees and the management. The researcher proposed to limit this study to these three variables as explained above. These are conceptualized as shown below;

**Independent Variables**

**Dependent Variable**



**Figure 2.1 Conceptual Framework**

**Operationalization of Variables**

The study operationalized the employee fraud management practices on fraud detection in small and micro enterprises in Migori town. The independent variables are; checks on employees-third party collusion, level of effectiveness of the whistle blower protection practice, the dependent variable is employee fraud.



**Table 2.1 Operationalization of the Study**

<b>Objective</b>	<b>Variable</b>	<b>Indicators</b>	<b>Measurement Scale</b>	<b>Questions in Questionnaire</b>
Fraud detection	Dependent	Frequency of asset misappropriation Frequency of management complains	Interval	5
checks on employees-third party collusion	Independent	Level of willingness of the management to report to shareholders Level of employee willingness to take	Interval	5
Level of effectiveness of the whistle blower system	Independent	Level of standard form of internal control Number of measures installed to deal with fraud	Interval	5
Level of efficiency of the Internal Control System	Independent	Level of standard form of internal control Number of measures installed to deal with fraud	Interval	7

## **CHAPTER THREE**

### **RESEARCH DESIGN AND METHODOLOGY**

#### **3.1 Introduction**

This chapter discusses the research design used in the study, the site of the study, the target and accessible population, sample size, sampling technique and procedure, data collection instrument, reliability and validity of research instrument, data management and analysis, data presentation and ethical considerations that were observed during the study.

#### **3.2 The Research Design**

The study used a descriptive survey research design. Descriptive survey design is appropriate for gathering information, summarizing, presenting and interpreting it for the purpose of explaining trends in a population. Similarly, descriptive survey design enables the researcher to study a number of variables to determine the current status of the population (Sanders et al., 2003). This design will enable the researcher to collect data and answer the pre-determined research questions concerning the current status of the population under study. This is the best research design for this study because it will enable the researcher to obtain the information required from the population regarding the different variables of the study. The design is deemed fit for collecting information on fraud management from employees working in Micro and Small Enterprises in Migori County.

#### **3.3 Target Population of the Study**

The target population was all staffs working at Micro and Small Enterprises in Migori County. The study target 478 management staff at Micro and Small Enterprises in Migori County (Micro and Small Enterprise Authority (MSEA), 2017).

**Table 3.1: Target Population**

Category	Number of businesses	Average Top Managers	Total
General Supplies	45	3	135
Manufacturing/construction	114	3	342
Supermarkets/whole-salers	216	3	648
Paint businesses, hardwares	103	3	309
<b>Total</b>	478		1434

### 3.4 Sample Size and Sampling Techniques

In this study a census survey was used as the appropriate sampling method for this research. Newman (2003) suggests that, for descriptive research where the total population consists of a small number, a census sampling technique is appropriate. In census survey, the researcher uses all the people in the target population as the sample. It means that the researcher included all staffs working in the small construction support businesses as the sample of the study. Therefore, the sample of the study was the 64 employees, according to Mugenda and Mugenda (2009), 10% of target proportion was representative sample of the entire population hence 142 respondents who form 10% of the target population is deemed fit for the study.

**Table 3.2 Sample size**

Category	Number of Employees	Sample proportion	Sample
General Supplies	135	10%	13
Manufacturing/construction	342	10%	34
Supermarkets/wholesalers	648	10%	65
Paint businesses, hardwares	309	10%	30
<b>Total</b>	1434	10%	142

### 3.5 Data Collection Instruments and Procedure

The researcher used a questionnaire to collect data from sampled respondents. The questionnaire was considered an appropriate instrument for this study since it was easier to administer within a relatively shorter time. The instrument comprised of closed ended

questions only. These closed questions provided optional answers for ease of filling so as to encourage respondents fill all questions and enable them to express their views on the variables under study. The questionnaire comprised of four sections. The first section captured the background information of the participants to help understand the demographic profile of the respondents. The rest of the three sections contained questions that would provide answers to the researchers study variables including internal control system section, employee collusion with third party and the whistle blower protection system. The questionnaires administered by 'drop and pick' method.

### **3.6 Reliability and Validity**

To establish the instruments reliability, study's research instruments was subjected to a pilot study where it was tested and retested (test-retest method) on a sample of 10 respondents. The instrument was administered twice to the same people within a time interval of two weeks and responses checked for stability and agreement of responses. The instrument was validated by calculating the Cronbach's alpha to determine if the information in the instrument is adequate to evaluate the applicability and appropriateness of the content, clarity and adequacy of its construction. The Cronbach's alpha was used to measure of internal consistency of the variables that is, how closely related a set of variable are as a group. The prescribed Cronbach's alpha threshold of 0.7 will be used as contended by Field (2009). Suggestions made were modified appropriately. Besides, the researcher explained the purpose of the study to the respondents so as eliminate any apprehension and eliminate fear while providing data.

### 3.7 Data Analysis and Presentation

The data collected was coded, data entry done into a computer using SPSS. Quantitative data was generated. The analysis of the data was done using descriptive statistics through measures of central tendency such as frequency and percentages. The analysis was aided by Statistical Package for Social Sciences (SPSS) tool. The correlation between the independent and dependent variables was determined by the use of regression analysis as follows;

$$y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \epsilon_i$$

Where;

y – Employee fraud management in organizations (EF)

$\alpha$  – The constant

$\beta_1, \beta_2,$  and  $\beta_3$  are the regression coefficients

$x_1, x_2, x_3$  – independent variables (IC, C, WP)

Therefore,

$$EF = \alpha + \beta_1 IC + \beta_2 C + \beta_3 WP + \epsilon_i$$

Where;

IC- Internal Control (Weak internal control system)

C – Internal Control (employee-third party collusion)

WP – Whistle blower Protection (Ineffectiveness of the whistle blower protection)

$\epsilon_i$  – is the error term

The Cronbach's alpha was used to measure of internal consistency of the variables, which is, how closely related a set of variable are as a group. Data will be presented using percentages, frequencies, tables and figures.

### 3.8 Ethical Considerations

The researcher got an authority letter from KCA University giving consent to carry out the study. The researcher put in place mechanisms to ensure that no one was harmed or suffered adverse consequences from this research activity. The researcher explained clearly the purpose of the study so as to obtain informed consent from the respondents. Furthermore the researcher upheld integrity by ensuring sincerity and honest in the entire research process to ensure that KCA University receives ethically conducted research and research report.

## **CHAPTER FOUR**

### **RESEARCH FINDINGS, PRESENTATION, DISCUSSION AND INTERPRETATIONS**

#### **4.1 Introduction**

This chapter presents the findings obtained from the study. The chapter presents the background information of the respondents and the findings of the analysis based on the objectives of the study. The data was analyzed using Statistical Packages for Social Sciences (SPSS) and data has been presented in frequency tables. Descriptive and inferential statistics have been used to discuss the findings of the study.

#### **4.2 Response Rate**

The study targeted a sample size of 130 respondents from which 114 completed and returned the questionnaires making a response rate of 87 percent. The response rate was representative. According to Mugenda and Mugenda (2003), a response rate of 50 percent is adequate for analysis and reporting; a rate of 60 percent is good and a response rate of 70 percent and over is excellent. This response rate was considered satisfactory to make conclusions from the study. Based on the assertion, the response rate was considered to be excellent.

#### **4.3 Reliability Analysis**

A pilot study was undertaken to pre-test data collection instrument for validity and reliability. According (Orodho, 2003), a pilot study is necessary for testing the reliability of data collection instruments. The pilot study involved 10 respondents who didn't form part of the study. Reliability of the questionnaire was evaluated through Cronbach's Alpha which measures the internal consistency and establishes if items within a scale measures the same construct. The index alpha was computed using SPSS and measured the average of measurable items and its correlation. Cronbach's Alpha was established for every variable which formed a scale as shown below;

**Table 4.1: Reliability Analysis**

<b>Variable</b>	<b>Cronbach's Alpha</b>	<b>No. of Items</b>
Internal Control System	0.849	8
Collusion between employees and third parties	0.723	7
Ineffectiveness of whistle blower protection system	0.741	6
Average	0.771	7

The table shows that internal control system had the highest reliability ( $\alpha= 0.849$ ), followed by ineffectiveness of whistle blower protection system ( $\alpha=0.741$ ), Collusion between employees and third parties ( $\alpha=0.723$ ). This illustrates that all the three variables were reliable as their reliability values exceeded the prescribed threshold of 0.7 as contended by Field (2009). The results of the reliability test also revealed that all the three variables were reliable as the average index of 0.771 exceeded the adopted threshold of 0.7. This is an indication that all the study variables- internal control system, collusion between employees and third parties and ineffectiveness of whistle blower protection system have a relatively high internal consistency and measures the same construct.

#### **4.4 Findings from Respondents**

Below is a presentation and discussion on the characteristics of the respondents;

##### **4.4.1 Demographic Information**

The study sought to determine some demographic information about the respondents. The respondents were requested to indicate their gender, level of education, age, position, department in the company.

According to the findings, most of the respondents as shown by 53.5% indicated were male while 46.5% were female. From these findings we can deduce that the respondents were distributed evenly across the gender. 42.1% of the respondents indicated that they had University level of education, 28.1% of the respondents indicated that they had college education, 6.1% of the respondents indicated that they had a primary education. These findings show that respondents who participated gave credible information since they had

attained the basic education to comprehend the questions. From the study findings, majority of the respondents as shown by 55.3 % were in finance department while 44.7% were in marketing department.

#### 4.4.2 Employee Fraud

The study sought to rate statements on employee fraud. The study sought to rate elements of employee fraud prevalent in organization; using a scale of 1 to 5.

**Table 4.2: Statements Relating to Fraud**

The respondents were asked to rate statements on employee fraud.

Statements	Very Large Extent	Large Extent	Neutral	Small extent	Very Small Extent	Mean	Std Deviation
Frequent assets misappropriation	5.3	49.1	20.2	11.4	14	3.73	1.01
Numerous audit queries on misappropriated assets	15.8	43.9	16.7	19.3	4.4	3.47	1.10
Deliberate misinterpretation of financial reports by employees	54	47.4	14.9	18.4	2.6	3.52	1.05
Irregular audit trails on material information of the company transactions	20.2	38.6	21.1	15.8	4.4	3.54	1.11

In this question a likert scale of 1 to 5 was used to interpret the results of the study. If the mean was found to be close to 1, the study regarded the statement very small extent, if the mean was found close to 2, the study regarded to small extent, if the mean was close to 3, the study regarded the statement as neutral, if the mean was close 4 the study regarded the statement Large extent and if the mean was close to five, the study regarded the statement Very Large Extent.



From the study findings in table 4.7, majority of the respondents indicated that frequent assets misappropriation to a large extent as shown with a mean of 3.73, numerous audit queries on misappropriated assets to a large extent as shown with a mean of 3.47, deliberate misinterpretation of financial reports by employees to a large extent as shown with a mean of 3.52, irregular audit trails on material information of the company transactions as shown in table 4.7 with a mean of 3.54.

#### 4.4.3 Internal Control System

**Table 4.3: Extent organization has placed good measures for preventing employee fraud**

<b>Extent</b>	<b>Frequency</b>	<b>Percent</b>
Very Good	2	1.8
Good	11	9.6
Fair	26	22.8
Poor	75	65.8
Total	114	100.0

The respondents were requested to indicate extent to which organization has placed good measures for preventing employee fraud, majority of the findings in table 4.8, 63.2% indicated the organizations had poor measures for preventing fraud.

**Table 4.4: Statements relating to the internal control system in preventing employee fraud**

Statements	Very Large Extent	Large Extent	Neutral	Small extent	Very Small Extent	Mean	Std Deviation
Failure of the management to establish a standard internal control system	5.3	14.9	20.2	11.4	14	3.2	1.16
Overconfidence with employees	16.7	42.1	21.9	10.5	8.8	3.47	1.15
Failure of the auditor in assessing quality of internal controls	5.3	14.9	20.2	11.4	14	3.20	1.16
Failure of reporting the presence of weak internal controls	9.6	43	23.7	11.4	12.3	3.26	1.16
Lack of measures installed to deal with employee fraud	5.3	14.9	20.2	11.4	14	3.20	0.16
Weak internal control systems for preventing fraud	5.3	14.9	20.2	11.4	14	3.20	0.11

In this question a likert scale of 1 to 5 was used to interpret the results of the study. If the mean was found to be close to 1, the study regarded the statement very small extent, if the mean was found close to 2, the study regarded to small extent, if the mean was close to 3, the study regarded the statement as neutral, if the mean was close 4 the study regarded the statement Large extent and if the mean was close to five, the study regarded the statement Very Large Extent.

From the study findings in table 4.9, majority of the respondents indicated to a large extent failure of the management to establish a standard internal control system as shown with a mean of 3.20, Overconfidence with employees as shown with a mean of 3.47, failure of the auditor in assessing quality of internal controls as shown with a mean of 3.20, failure of reporting the presence of

weak internal controls as shown with a mean of 3.26, lack of measures installed to deal with employee fraud as shown with a mean 3.20, weak internal control systems for preventing fraud as shown with a mean of a mean of 3.20.

#### 4.4.4 Collusion Between Employees and Third Parties

The respondents were requested to indicate who have the highest probability of deceiving stockholders in your company.

**Table 4.5 Who have highest probability of deceiving stockholders in your company**

	Frequency	Percent
Top executives	19	16.7
The management	59	51.8
Lower level staffs	36	31.6
Total	114	100.0

According to the findings majority of the respondents in table 4.10, 16.7% indicated top executives the highest probability of deceiving stockholders in your company, 51.8% indicated the management and 31.6% indicated lower level staffs.

**Table 4.6: Statements relating to the collusion between employees and third parties**

Statements	Very Large Extent	Large Extent	Neutral	Small extent	Very Small Extent	Mean	Std Deviation
Manipulating records	22.8	50.0	14.9	10.5	1.8	3.90	0.91
Obtaining finances through false presences	24	69	10	11		3.92	0.82
Concealing material statements	28	31	43	12		3.66	0.96
Inconsistent overtime hours for a cost center,	34	33	34	13		3.77	1.00
Increasing vendor invoices	9	87	18			4.19	0.76
Reluctance to provide information to investors and auditors	9	87	18			3.92	0.48
Management decisions are dominated by an individual or small group	26	59	29			3.97	0.69

In this question a likert scale of 1 to 5 was used to interpret the results of the study. If the mean was found to be close to 1, the study regarded the statement very small extent, if the mean was found close to 2, the study regarded to small extent, if the mean was close to 3, the study regarded the statement as neutral, if the mean was close 4 the study regarded the statement Large extent and if the mean was close to five, the study regarded the statement Very Large Extent.

From the study findings in table 4.11, majority of the respondents indicated to a large employee collude through manipulating records as shown with a mean of 3.90, obtaining finances through false presences as shown with a mean of 3.92, concealing material statements as shown with a

mean of 3.6, inconsistent overtime hours for a cost center as shown with a mean of 3.77, increasing vendor invoices as shown with a mean of 4.19, reluctance to provide information to investors and auditors as shown with a mean of 3.92, management decisions are dominated by an individual or small group as shown with a mean of 3.97.

#### 4.4.5 Ineffectiveness of Whistle Blower Protection System

**Table 4.7 Whether company have a whistle blower system**

	<b>Frequency</b>	<b>Percent</b>
No	78	68.4
Yes	36	31.6
Total	114	100.0

The respondents were requested to indicate whether company have a whistle blower system, according to the findings table 4.12, 68.4% of the respondents indicated the company does not have a whistle blower system, while 31.6 % of the respondents indicated their company have whistle blower system.

**Table 4.8 Extent you agree that the ineffectiveness of the whistle blower system contributes to employee fraud**

	<b>Frequency</b>	<b>Percent</b>
To a Very Small Extent	47	41.2
Small Extent	23	20.2
Neutral	6	5.3
Large Extent	18	15.8
Very Large Extent	20	17.5
Total	<b>114</b>	<b>100.0</b>

The respondents were requested rate the ineffectiveness of the whistle blower system contributes to employee fraud 41.2% of the respondents indicated ineffectiveness of the whistle blower system contributes to employee fraud as shown in table 4.13.

**Table 4.9: Statements relating to ineffectiveness of whistle blower protection system contribute to employee fraud.**

Statements	Very Large Extent	Large Extent	Neutral	Small extent	Very Small Extent	Mean	Std. Deviation
Internal supervising systems fail to protect informers to management regarding detected fraud	5.3	14.9	20.2	11.4	14	3.20	1.09
Traditional values held by employers in organizations diminish the autonomy of employees to disclose any information that may help in establishing fraud	35	42		24		3.47	1.10
Whistle blowers harassment by co-workers upon disclosure of fraud		33	49	32		3.20	0.75
Denial of advancement by supervisors upon disclosure of fraud	39	63	12			3.47	0.62
Threat of expulsion and termination of employment to whistle blowers	30	56	28			3.20	0.75
Demotion of employees who expose fraud information face in the organization	15	83	15			4.00	0.52

In this question a likert scale of 1 to 5 was used to interpret the results of the study. If the mean was found to be close to 1, the study regarded the statement very small extent, if the mean was found close to 2, the study regarded to small extent, if the mean was close to 3, the study regarded the statement as neutral, if the mean was close 4 the study regarded the statement large extent and if the mean was close to 5, the study regarded the statement very large extent..

From the study findings in table 4.14, the respondents indicate to large that internal supervising systems fail to protect informers to management regarding detected fraud as shown with a mean of 3.20, Traditional values held by employers in organizations diminish the autonomy of employees to disclose any information that may help in establishing fraud as shown with a mean of 3.47, whistle blowers harassment by co-workers upon disclosure of fraud as shown with a mean of 3.20, denial of advancement by supervisors upon disclosure of fraud as shown with a mean of 3.20, threat of expulsion and termination of employment to whistle blowers as shown with a mean of 4.01, demotion of employees who expose fraud information face in the organization as shown a mean of 4.00.

#### 4.5 Regression Analysis

Regression was conducted to establish the relationship between the independent variables (internal control, employee-third party collusion, whistle blower protection and dependent variable (Employee fraud management in organizations).

**Table 4.10: Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.767 <sup>a</sup>	.589	.577	.49889

Adjusted R squared is coefficient of determination which tells us the variation in the dependent variable due to changes in the independent variable. From the findings, the value of adjusted R squared was 0.589 an indication that there was variation of 58.9% on employee fraud management in organizations due to changes in internal control, employee-third party collusion, whistle blower protection at 95% confidence interval. This shows that 58.9% changes on employee fraud management in organizations could be accounted for by internal control, employee-third party collusion and whistle blower protection. R is the correlation coefficient which shows the relationship between the study variables. From the findings, the study found that there was a strong positive relationship between the study variables as shown by 0.767.

**Table 4.11: Coefficients**

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	Constant	-.833	.0369		-2.258	.026
	Internal Control	-0.295	.380	-.307	-.777	.439
	Employee-third party collusion	0.785	.083	.624	9.486	.000
	Whistle blower Protection	0.771	.434	.703	1.778	.0078

Using multiple regression analysis, the study sought to establish effect of determinants of employee fraud management. Assuming a linear relationship between the independent and the dependent variable, the relationship between the independent and dependent variables as presented by the regression model was tested. The multiple regression equation will be:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon$$

Whereby  $Y = EF = \alpha + \beta_1 IC + \beta_2 C + \beta_3 WP + \varepsilon_i$

Where;

$Y =$  **Employee fraud management**

$IC =$  Internal Control (Weak internal control system)

$C =$  Internal Control (employee-third party collusion)

$WP =$  Whistle blower Protection (Ineffectiveness of the whistle blower protection). From the data in the above table the established regression equation was;

$$Y = -833 - 0.295IC + 0.785C + 0.771WP$$

From the above regression equation, it was revealed that internal control system at a constant zero, employee fraud management would be at -.833, this indicates in absence of internal controls, Employees-Third Party Collusion and whistle blower protection system the fraud management would decrease. A unit increase in internal control would decrease



employee fraud management with a factor of 0.295 this is an indication that in the organization where strict measures has been put in place the fraud management might decrease where senior management get more confident with employees and this opens loopholes for fraud, a unit increase in employee-third party collusion would lead to increase in employee fraud management by a factor of 0.785 and a unit whistle blower protection would lead to increase in employee fraud management by a factor 0.771.

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1 Introduction**

This chapter presents and discusses the key data findings from the study, draws conclusion from the findings, and makes appropriate recommendation. The conclusions and recommendations drawn were focused on addressing the objective of the study, effect of internal control system on employee fraud management in micro enterprises, to determine the effect of employee-third party collusion on employee fraud management in micro enterprises, to examine the effect of whistle blower protection system on employee fraud management in micro enterprises.

#### **5.2 Summary of the Study**

The main aim of the study is to investigate determinants of employee fraud management in micro and small enterprises in Migori town, Kenya. The respondents were well distributed across the gender and understood the content of the questionnaire gave credible information.

##### **5.2.1 Effect of internal control system on employee fraud management in micro enterprises.**

The study found out that internal control system affect employee fraud management which is caused failure of the management to establish a standard internal control system. The study further found that overconfidence with employees, failure of the auditor in assessing quality of internal controls, failure of reporting the presence of weak internal controls, lack of measures installed to deal with employee fraud, weak internal control systems for preventing fraud also influence fraud management. The study concur with findings by According to Idowu (2009), internal controls in an organization is a good measures of preventing fraud and especially on the part of employees. The study also concurs with Fakunle (2006), Robertson (1996) and also in the work of Hamby (1998); employee fraud, according to him are now becoming a global phenomenon.

### **5.2.2 Effect of employee-third party collusion on employee fraud management in micro enterprises**

The study found that employees collude through manipulating records, obtaining finances through false presences, concealing material statements, inconsistent overtime hours for a cost center, increasing vendor invoices, reluctance to provide information to investors and auditors, management decisions are dominated by an individual or small group. Balogun et al., (2013) says that collusion of employees to cause fraud and often involves the manipulation of the records and the accounts and the study conform to these findings that Top management have the highest probability of having fraudulent activities against the stockholders. The study also concur with Deevy and Beals (2013) who found that Collusion of employees between themselves and third parties also involves the creation of phantom participants to obtain benefits, theft of instruments or personalize instruments intended for particular participants

### **5.2.3 Whistle Blower Protection System and Employee Fraud Management in Micro Enterprises**

The study found that internal supervising systems fail to protect informers to management regarding detected fraud; traditional values held by employers in organizations diminish the autonomy of employees to disclose any information that may help in establishing fraud. The study also found that whistle blowers harassment by co-workers upon disclosure of fraud, denial of advancement by supervisors upon disclosure of fraud, threat of expulsion and termination of employment to whistle blowers, demotion of employees who expose fraud information face in the organization. The study concurs with findings by Ratley (2016) who argue that many of the employees fail to disclose fraud behaviors and activities for the fear of termination, demotion, harassment by co-workers, the denial of advancement as well as other ways of discrimination. The study concur also with Ayagre and Aidoo-Buameh (2014) who argued that employees with critical information about fraud in the organization need protection after disclosing any misbehavior by the management or fellow employees that may lead to fraud. Ye (2011) also indicated that The duty of loyalty by em-

employees requires that they do everything that benefits their employers as well as the organization.

### **5.3 Conclusion**

The study concludes that internal control systems rest mostly influence employee fraud management, for a control system to be described as effective, control policies and procedures must not be under the influence of one person. When such a thing happens that individual can easily override the controls and the employee fraud increases.

### **5.4 Recommendations**

The study recommends that business owners should engage in training and for their employees on internal controls. They should be confident enough when it comes to controls because internal controls are vital to the success of a business. The business owners, amongst themselves in an area should organise workshops and seminars more frequently. This initiative would give them a platform to learn from each other about how to implement and follow the controls on fraud management.

Incentives and appraisals should be given to employees who adhere to the internal controls and facilitate whistle blower system. Business owners should design the policies regarding internal controls which will act as a guide to follow internal controls. These policies should be easy to follow and should be changed every time there is a breach of internal controls. Systems for detecting problems faced businesses (embezzlement of records, and asset misappropriation) should be put in place so that any occurrence of such matters is reported immediately.

### **5.5 Recommendations for Further Research**

The study sought to determinants of employee fraud management in micro and small enterprises in Migori town, Kenya. The study recommends that a research should be done on public sector too and analyze frauds by civil servants and how it affects performance of parastatals or ministries where these civil servants work.

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Dear Respondent

**RE: LETTER OF TRANSMITTAL OF DATA COLLECTION**

I am undertaking research in partial fulfillment for the award of a Master Degree at KCA University. The study being undertaken is on “*determinants of employee fraud management in micro and small enterprises in Migori town, Kenya*”.

Your assistance on provision of data will be highly appreciated as the study will assist the management of the companies understand the determinations of employee fraud. Assurance is given that the information given will be for the above purpose and will be treated in confidence and will only be used for academic purposes.

Attached herewith, please find a questionnaire that requires you to provide information by answering the questions.

Thank you for your co-operation.

**Yours faithfully**

**Everlyne Ateya Chimwene**

## APPENDIX II: QUESTIONNAIRE

1. Gender

Male [ ]

Female [ ]

2. What is your highest education level?

No formal education [ ]

Primary [ ]

Secondary [ ]

Diploma/ Certificate [ ]

Undergraduate degree [ ]

Postgraduate degree [ ]

3. What is your age bracket?

18 - 25 Years [ ]

26 - 35 Years [ ]

36 - 45 Years [ ]

46 - 55 Years [ ]

55 and above [ ]

4. What is your Position in the Company?

Employee [ ]

Director [ ]

5. What is your department in the Company?

Finance [ ]

Marketing [ ]

**SECTION A. EMPLOYEE FRAUD DETECTION**

In this section the researcher aims to rate the prevalence of fraud in the organization. Indicate to what extent does the following elements of employee fraud prevalent in your organization, rate the following concerns using a scale of 1 to 5 where 1= To a very Small Extent 2= Small extent 3= Neutral, 4= Large Extent and 5 = Very Large Extent

		1	2	3	4	5
6	Frequent assets misappropriation					
7	Numerous Audit queries on misappropriated assets					
8	Deliberate misinterpretation of financial reports by employees					
9	Irregular audit trails on material information of company transactions					

**SECTION B. LEVEL OF EFFICIENCY OF THE INTERNAL CONTROL SYSTEM**

10. In this section the researcher aims to rate key concerns that may limit the Level of efficiency of the Internal Control System in preventing employee fraud. Use the 5-point Likert Scale as follows; 1= To a Very Small Extent; 2 = Small Extent; 3 = Neutral; 4= Large Extent; and 5= To a Very Large Extent.

Indicate to the extent to which you think your organization has placed good measures for preventing employee fraud.

To a Very Small Extent [ ]

Small Extent [ ]

Neutral [ ]

Large Extent [ ]

To a Very Large Extent [ ]

**11.** Indicate the extent do you agree the following are key concerns that may limit the internal control system in preventing employee fraud? Use the 5-point Likert Scale as follows; 1= To a Very Small Extent; 2 = Small Extent; 3 = Neutral; 4= Large Extent; and 5= To a Very Large Extent

		1	2	3	4	5
11	Failure of the management to establish a standard internal control system					
12	Overconfidence with employees					
13	Failure of the auditor in assessing quality of internal controls					
14	Failure of reporting the presence of weak internal controls					
15	Lack of measures installed to deal with employee fraud					
16	Weak internal control systems for preventing fraud					
17	Others (Specify.....)					

**SECTION D. CHECKS ON EMPLOYEES-THIRD PARTY COLLUSION**

Who have the highest probability of deceiving stockholders in your company?

Board to Directors [ ]

Top management [ ]

Lower level staffs [ ]

Shareholders [ ]

All employee [ ]

18. To what extent do you agree that the employees collude in the following ways to defraud the company. Use the 5-point Likert Scale as follows; 1= To a Very Small Extent; 2 = Small Extent; 3 = Neutral; 4= Large Extent; and 5= To a Very Large Extent

		1	2	3	4	5
19	Manipulating records					
20	Obtaining finances through false presences					
21	Concealing material statements					
22	Inconsistent overtime hours for a cost center,					
13	Increasing vendor invoices					
24	Reluctance to provide information to investors and auditors					
25	Management decisions are dominated by individuals					
26	Management decisions are dominated small group					

### SECTION E. WHISTLE BLOWER PROTECTION PRACTICE

To what extent do you agree that the ineffectiveness of the whistle blower system contributes to employee fraud?

1=To a Very Small Extent [ ]

2 = Small Extent [ ]

3 = Neutral [ ]

4= Large Extent [ ]

5= To a Very Large Extent [ ]

To what extent do you agree that the ineffectiveness of whistle blower protection system contribute to employee fraud. Rate the following elements that lead to ineffectiveness of whistle blower protection system using a scale of Use the 5-point Likert Scale as follows; 1= To a Very Small Extent; 2 = Small Extent; 3 = Neutral; 4= Large Extent; and 5= To a Very Large Extent

	1	2	3	4	5
Internal supervising systems fail to protect informers to management regarding detected fraud					
Traditional values held by employers in organizations diminish the autonomy of employees to disclose any information that may help in establishing fraud					
Whistle blowers harassment by co-workers upon disclosure of fraud					
Denial of advancement by supervisors upon disclosure of fraud					
Threat of expulsion and termination of employment to whistle blowers					
Demotion of employees who expose fraud information face in the organization					