

# Banking and Accounting Issues

## Chapter 12

### Payroll Fraud and Fraud Detections Methods in Nigeria

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#### **Payroll Fraud**

As said earlier, fraud is perceived to be different facets. It is any act or action in which the legal element of fraud: Intention, false representation, material facts and harm are present. Thus, payroll fraud is a type of fraud perpetrated through the payroll system of the company. It is done by deliberate falsification of payroll contents to make an employee get what he/she suppose not to receive or get more that what he/she should have gotten. Accounting Tools (2019), described payroll fraud as "the theft of cash from a business via the payroll processing system". The article mentioned "advances not paid back", "buddy punching", "ghost employees", "paycheck diversion", "pay rate alteration" and "unauthorized hours" as types of payroll frauds.

The term payroll can be seen from both a narrow and broad perspectives. In the narrow view, it is referred to as a list of employees who get paid from particular company usually showing individual employee pay information. Payroll in the broad perspective refers to the totality of compensation a business pays its employees in a given period of time. Payroll expenses are labour costs which include salaries and wages of employees which he/she takes home and other payments that the employer makes on behalf of the employee such as health, insurance and similar benefits Accounting Tools (2019). At its micro level and depends on the nature of the business entity, payroll would contain the following content as identified by Mike (2015): employee information, hours worked, time off, overtime pay, fringe benefits, other pay, deductions – payroll taxes, garnishments, gross and net pay. The content of payroll in private sector varies with that of the public sector. Payroll obtained from one of the MDAs in the state. Fraud (including payroll fraud) is a problem that confronts every country in the world even though it appears to be most pronounced in developing countries. As indicated by Transparency International (2018), over two- third of the 180 countries and territories surveyed scored below 50% in 2018; thus indicating the extent fraud and fraudulent practices are perpetrated globally. Most of these frauds are committed by employees who have detailed knowledge of the internal systems of the organization. Fraud could also be committed by an organization against other individuals and institutions Gbalam (2015).

The term fraud is defined by different authors in different but related ways. The root meaning of the Latin word, from which fraud is taken, carries a variety of meaning. These could be summed up in the way fraud is perceived in the law. "In law, fraud is intentional deception to secure unfair or unlawful gain or to deprive a victim of a legal right" Wikipedia (2019). Some others as cited by Gbalam (2015), perceived fraud as deliberate falsification,

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concealment or omission of facts with the intention of deceiving a person or organization which would result to financial detriment to the victim.

As Gbalam (2015) opined, that no list can contain all the types of fraud, but he listed 26 common types of fraud. Among these type is occupational fraud which is also known as internal fraud. Occupational fraud, are frauds committed against the company by those whom it engages to provide services for the company the employees. These try to enrich themselves through illegitimate means such as the misuse of economic resources of the entity. One aspect of internal fraud is payroll fraud. It is a serious problem that has plagued many organizations both in the public sector and the private sectors of the economy. News paper publications and so forth attests to the gravity and prevalence of payroll fraud in MDAs in Nigeria and Bayelsa state in particular. It is a fraud committed through the payroll system of organization. In this study however, ghost employees and staff grade falsification which is similar to pay rate alteration mentioned in the article are used as dimension of payroll fraud.

### **Ghost employee:**

This is an illegitimate name contained in the payroll of an organization. It is perpetrated through the payroll staff who, either creates a fake employee in the payroll records or maintain the pay of an employee who had left the company and alter the payment record so that the direct deposit payment is directed to self. It works efficiently in situations where company employees are large in number and where supervisors have a large number of staff under their control thereby making of difficult to track compensation in sufficient detail. It also works well where a supervisor has left the company but is yet to be replaced. Payroll staff could then include names in the group of employees under the supervisor that has left the organization (Accounting Tools, 2019).

The staff strength of some MDAs in Bayelsa State is very large due to the nature and scope of its activities. While this often creates difficulties in control and supervision of payroll; it serves as avenue for ghost employee inclusion in the payroll by responsible staffers.

### **Staff grade falsification:**

The position an employee occupies in the civil service reflects the grade level. On the other hand, the emolument of an employee is dependent on the grade level. Thus, staff grade falsification is concerned with altering an employee's salary grade/steps so as to place such an employee at higher level for the purpose of getting more salary. It is similar to pay rate alteration identified by Accounting Tools (2019). "It is a fraud scheme whereby employees connive with the payroll clerks to increase the amount of their hourly pay in the payroll system. A cleverer clerk will then return the pay rate to its original level after committing this fraud for just a few pay periods so that the issue is less easy to spot" .In the context of MDAs', employees connive with payroll staff to increase staff grade levels and steps to earn a higher pay for a consideration of kick-backs. In this case, the employee benefits from the frauds scheme successfully executed through payroll staff while the latter paths with lump sum or monthly kick-backs.

### **Fraud Detection Methods**

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There is not one method employed to detect fraud. Different techniques are used for different types of fraud. As cited by Gbalam (2015), ACFE report in 2006, indicated six methods of which internal fraud can be detected. These consist of tips, by accidents, internal audit, internal controls, external audit and notification by the police. The potential of these techniques to discover fraud varies.

The report above indicates that 34.2% of fraud incidences are discovered by means of useful piece of information from an employee, vendor, customer or other person(s) who deal with the organization. The message is clear, fraud detection efforts can yield success if hot lines are provided for the public to report any suspected fraud. Internal audit comes third in the above rankings. It is the potentials of the internal auditor that can effectively help in fraud discovery. Hence in this study, the integrity and objectivity, and competence of the auditor are used as the causative variables to detect ghost worker in payroll being the resultant variable.

Payroll fraud and fraud in general has great impact on any business organization and the society at large. Regarding the effect fraud has on you and your organization, John Freedman (2019) identified financial loss, lack of external confidence, company moral and increased audit costs as effects of fraud. These are true even in the public service. Quite large amounts of money have been lost to these fraudsters by the government and this has brought the country to very high position among the world's most corrupt countries. Such amount would have improved the social and economic well of the citizenry. Also, it has resulted in increased audit cost as different panels and bodies have been constituted at one time or the other, to address such cases. Fraud effects are systematic in nature hence the government intensifies her effort to detect fraud.

### **The Concept of Public Sector (MDAs)**

The term is broad in meaning. It can be seen as all organizations established by the law of the country, owned, managed and controlled by it. It is described as any establishment that is being identified by the law, owned, managed, financed and as well controlled by the federal, state or local governments (Onuchuku, Kalabgor and Nuka, 2012). Public sector can also be seen as that aspect of the economy in which the government engages in to provide goods and services to her citizenry. Basically public sector consists of the three organs of government, the executive, legislative, and the judiciary arms of government. This is different from public enterprises which are also known as parastatals. They are established by law to deliver public goods and services but are largely independent of the government in terms of management and control. However, often times, public enterprises get their own revenue through the services they render and with subvention from the government; and in most cases, government is the major shareholder. In other to discharge her duties to the public, that is; the citizenry, the government established different ministries to execute its policies and programmes. For instance, the ministry of education is to ensure that the government educational programmes and policies are pursued and implemented; the ministry of health, for health matters and so forth. Within the ministry, departments are also created to handle specific functions in the ministry. Such department includes, Finance & Supply, Human Resources, Inspectorate, Public Relation and much more. To cater for the expanded scope of activities, ministries also have agencies that operate under their supervision and control. For example, the ministry of education has the Post Primary Schools Board (PPSB) as its agency, performing educational services to the citizens hence, the acronym MDAs.

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## **Fraud Detection and Control in MDAs:**

The government at the apex, to which ministries report to is concerned with the way MDAs, operates. It expects probity, transparency and accountability in the control and management of public funds and resources of the government on the part of the MDAs. This is because of the complexity involved in the administration of government activities. To attain this aim, government put in place, rules and regulations. These rules include the "Public service Rules" and "Financial Regulations". While former is concerned much with administrative procedures the latter focuses on the management and control of the financial resources of MDAs.

## **Financial Regulation of Nigeria**

The Financial Regulation of Nigeria (FR) (2009), provides two key sections that are of relevance to the detection of payroll fraud and these are: Chapter 15, Salaries and chapter 17 Internal audit .Below is a brief discussion of these chapters in relation to pay roll fraud detection and control. Salary refers to the monthly emolument paid to an employee of an organization (MDA) for services rendered to such organization. The payment is based on a predetermined rate. It requires that every officer in the employment is entitled to receive salary (section 1501 and 1502). This provision makes it clear that whoever that is not employed by government, such a person is not rendering service to the government hence is not legible for payment of salary Section 1506-1508 provides measure to ensure that salaries of employees who have left the service discontinue in the payroll system thus eliminating the situation whereby fund is diverted through their names. The chapter also requires the accounting officers to keep proper records of all employees in a prescribed form. Part II of chapter 15 deals with payroll preparation and control. 1520 states "where the accounting system in manual, the Head of Finance and Accounts Department shall ensure that the personal emolument record card are kept under strict security arrangements, and that when they are not in use, they are locked in a fire-resistant cabinet, safe or strong room".

1521(i) provides "every officer shall complete the personal emolument record form annually which must be certified by his head of department or any other designed officer". (ii) "the completed personal emolument form shall be the basis for opening the group registers which must be audited before inclusion of any officer in the payroll.

The above provision could be summarized as follows:

- i. keep employment records for each employee
- ii. conduct internal audit of these records annually
- iii. employee records should be certified by the HOD who will be held liable for any falsification.

In addition to these, the chapter provides under section 1522, that in any month where salary variation occurs, the cause should be reported to the salary section at the earliest possible time and that the information be reported to the payroll section, internal audit, copy to be kept in the variation advice file and a copy in the affected officer's file. These are some of stringent measures put in place for the salary section to combat payroll fraud.

Chapter 17 deals with internal audit practice: Internal audit practice in government is subject to rules and regulations. Section 1701(i) places the responsibility on the Accounting officer of the MDA to establish internal Audit unit and outlined the functions of the unit to include the conduct of a comprehensive and continuous audit of the accounts and records of revenue and expenditure, assets, allocated and in allocated stores.

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Section 1703 creates an atmosphere of independence as it requires that the internal auditor report directly to the Accounting Officer in the MDA on a monthly basis. 1706(i) provides that such report could be monthly, quarterly or half-yearly and copies forwarded to the Accountant General and the Auditor General.

To ensure the integrity of the internal audit unit, section 1709 provides that staffers of the unit shall not be employed within MDA who are on accounting duties and that, persons who had engaged in accounting duties previously in such MDA are not illegible. Strict compliance with these and other provision in FR is sure to eradicate payroll fraud. However, payroll fraud occurs as often as possible.

### **Determinants of Payroll Fraud Detection:**

No doubt, Government placed structures to ensure that payroll fraud is promptly detected. This mechanisms are intended to identify and locate fraud before, during and after the fraudulent action is taken. The before aspect is concerned with detecting fraud trial. Perpetrators would first try or attempt the act to see whether it can work out. The 'during' aspect of fraud detection deals with uncovering fraud activities that have been going on in the system for a while and the after fraud activity is concerned with payroll fraud which was carried out without discovery but was later discovered after the fraudulent activity have ended Gbalam (2015).

These structures and mechanisms use human efforts to succeed, thus the effectiveness of the control depends on the person responsible. To this end, the codes of ethics of internal auditors as used in the study are integrity and objectivity, and competence.

### **Steps to Fraud Detection:**

Gbalam (2015), opined that fraud detection starts with having knowledge of red flags, the symptoms of the presence of fraud. This is followed by having knowledge of why employees or payroll officer perpetrate fraud, identification of high fraud risk transactions, identification and use of specific detective practice and a thorough follow up the red flags. In a similar vein, Scott (2009), listed the following as the steps that can be taken to detect fraud;

- i. Know the exposures
- ii. Know the symptoms of occurrence
- iii. Be alert for the symptoms and behavior indicators
- iv. Build audit programs/detective processes to look for symptoms
- v. Follow through all symptoms observed

From all indication knowledge is key to fraud detection as this enable the internal auditor to know what to do, when to do, and how to do what to do. For this reason knowledge is used as a dimension of competence.

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