INTERNAL AUDIT AND FRAUD DETECTION IN SELECTED MONEY TRANSFER COMPANIES IN PUNTLANDLAND, SOMALIA

A Thesis

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Degree in Finance and Accounting

By:

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DECLARATION A

"This thesis is my original work and has not been presented for a degree or any other academic award in any university or institution of learning".

AHMED ABSHIR JAMA

Name and Signature of Candidate

18th September, 2012

Date

DECLARATION B

"I confirm that the work reported in this thesis was carried out by the candidate under my supervision".

DR Jonas Onyunwense

Name and Signature of Supervisor

18/9/2012

Date

DEDICATION

"I dedicated this important professional achievement to my beloved parents; my mother Hawa Ismail Adam and my Father Eng. Abshir Jama Hasan; because without their presence, support, and comprehension I would have not achieved my goal. I love you."

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ABSTRACT

This study examined the influence of internal audit on fraud detection of six money transfer companies in Puntland, Somalia. A self-made questionnaire is used to collect data in order to obtain four research objectives; 1) to identify the profile of the respondents, 2) to determine the extent of internal audit, 3) to find out the level of fraud detection, 4) to establish if internal audit function is significantly correlated with fraud detection. And the study used descriptive survey design in order to compare the level of internal audit to fraud detection the sample of this study was 109 respondents from six money transfer companies in Puntland, Somalia. Key findings from the study were (1) the profile of the respondents found that male employees (87.2%) dominates female (12.2%), in regard to education level, respondents who are secondary level (14.7%), those who have diploma are (20.2%), those who obtained bachelor degree are (50.5%) where as master degree is (14.7%) and none of the respondents have Ph.D, the length of work experience that (72.4%) of the respondents have less than 6 years and only (27.6%) have more than 7 years of experience, followed by the age of respondents who are less than 59 years are (98.2%) and who are above 60 years are (1.8%); (2) the overall level of internal audit found satisfactory (mean=2.81); (3) the overall level of fraud detection is also found satisfactory (mean =2.80); (4) the study also found that there exists a significant positive correlation between internal audit and fraud detection. It was concluded that there is a significant relationship between the level of internal audit and fraud detection in the selected money transfer companies in Puntland Somalia, and also internal audit contributes 38% in the variation of the level of fraud detection. Based on the findings, it was recommended that top management should give input for internal audit planning in money transfer companies in Puntland, Somalia and Internal audit function of the money transfer companies should be independent in order to detect fraud fairly.

TABLE OF CONTENTS

LIST OF TABLES

CHAPTER ONE

THE PROBLEM AND ITS SCOPE

Background of the Study

Internal audit is an important part of corporate governance structure within an organization. Corporate governance includes those oversight activities undertaken by the board of directors and audit committee to ensure the integrity of the financial reporting process Public Oversight Board (1993). Three monitoring mechanisms have been identified in the corporate governance literature. They are external auditing, internal auditing, and directorships Anderson, Francis and Stokes (1993), Blue Ribbon Committee (1999). The Institute of Internal Auditors (IIA) adopted a perspective that explicitly included a fourth cornerstone of corporate governance – the audit committee (IIA 2003). In recent years, high profile corporate collapses have focused attention on corporate governance and also emphasized internal auditing as part of the governance process. The IIA sees the objective of internal auditing as both supporting and strengthening the organization's governance mechanisms and evaluating and improving the effectiveness of risk management and control IIA (1999).

The importance of internal auditing has also been recently underpinned by the decision of the New York Stock Exchange (NYSE) to amend its listing requirements to mandate that all listed companies in the United States (US) have an audit committee NYSE (2003) to liaise between internal auditors, external auditors and management, ensuring the independence of the audit function. There is evidence in the US that the Securities and Exchange Commission (SEC) also attaches importance to internal auditing as there have been recent cases where enforcement actions by the SEC and subsequent settlements have required the registrant to engage internal auditors (Carcello, Hermanson and Raghunandan 2005). Recent changes to the Corporations Act and the Australian Stock Exchange (ASX) Listing Rules have strongly emphasized the importance of good corporate governance. Given the perceived importance of internal audit as part of good corporate governance, these changes are likely to enhance the role and value of internal audit in the Australian environment.

A way of evaluating the work of the internal auditor is to examine how well they detect fraud within an organization and there has been limited research on this topic. The number and magnitude of errors requiring adjustment by the external auditor have been found to be substantially lower for entities that had an internal audit department compared to those that did not have an internal audit department Wallace and Kreutzfeldt (1991). This finding highlights the important role internal auditor's play in financial statement and asset misappropriation fraud detection.

Fraud has been one of the most problematic and prevalent issues for business worldwide for a long time; however, there has been much more attention and research dedicated to the topic after the scandals such as Enron, WorldCom and others. The 5th Global Economic Crime Survey performed by PwC (2009) reports that fraud remains a pervasive business risk and almost every firm is subject to financial statement fraud in their daily business, leading to huge losses for business and society. Increase in financial statement fraud and number of corporate scandals had an important impact on understanding and analyzing fraud and in turn on audit and its regulation. In recent years the importance of good corporate governance has received significant public and regulatory attention. A crucial part of an entity's corporate governance is its internal audit function. At the same time, there has been significant public concern about the level of financial statement fraud within organizations.

Due to the number of high profile corporate failures in recent years, corporate financial statement fraud has been of significant public and regulatory interest. The penalties for fraudulent financial reporting have significantly increased to reflect society's view on this type of behavior. For example, Bernard Ebbers the former chairman of WorldCom was recently jailed for 25 years for orchestrating a $US11 billion financial statement fraud Belson (2005). This increased importance has affected the work of the internal auditor. In Australia, the Australian Auditing Standard AUS 210

"The Auditor's Responsibility to Consider Fraud and Error in an Audit of a Financial Report" has been amended a number of times in recent years to increase the external auditor's responsibility in this area AARF (2004). It defines fraud as "...an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage." (AUS 210, para. .06) AUS 210 continues by stating that there are two types of intentional misstatements relevant to the auditor. Firstly, there are misstatements that result from fraudulent financial reporting and secondly, there are misstatements that result from misappropriation of assets.

Diaspora funds to Somalia are the largest source of foreign currency. It is estimated that 90% of foreign exchange earnings are generated by remittances/Hawala. Two thirds of the urban population relies on remittances and 80% of startup capital for businesses is funded from remittances. Remittance flows to Somalia strengthen livelihoods for hundreds of thousands of families and contribute to the development of the private sector in a country where foreign assistance has fallen short and functioning government has been virtually non-existent Khalid (2000).

Statement of the Problem

One of the most significant risks that the organizations face is the risk of collapse due to fraud. Risk of fraud involves intentional misstatement including omissions of amounts or disclosure in financial statement to deceive financial statement users it also involves misappropriation of asset. Despite internal audit in place, fraud detection function seems to be lacking in many organizations in Somalia particularly in many transfer companies and this shall lead to a negative consequences on the operation and credibility of money transfer companies in Somalia such as reduction of clients, not attracting investors and finally the closure of such organization.

Sound Internal audit is one of the principal means by which fraud is managed. According to Flesher (1996), the internal audit activity should monitor and evaluate the effectiveness of the organization's risk management system.

It does not matter the size and type of the organization, the risk of fraud is increasing at a rapid rate as the case in international scandals like Enron and WorldCom, also Somali money transfer organizations are running a lot of money as mentioned in the background of the study, thus the risk of fraud is always expected to be high in country without properly functioning government; which the basic regulatory agencies does not function properly or even not existing. As a result, the situation of fraud detection in Somali Money Transfer Companies has raised a question how internal auditing can work efficiently in a war-torn country like Somalia. And the researcher attempted finding solution for that gigantic problem which sounds action-demanding.

Purpose of the Study

The purpose of this study was to investigate the relationship between the internal audit and fraud detection. It also aimed to validate the theory to which the study is based on and to bring the gaps identified during the literature review. It therefore intended to test the researcher's hypothesis that there is no significance relationship between internal audit and fraud detection in money Transfer Companies in

Puntland, Somalia. It also intended to make conclusions and generalization as well as recommendations arising from the empirical findings.

Research Objectives

General: This study determined the relationship between internal audit and fraud detection of selected money transfer companies.

Specific: The specific objectives of the study include the following:

1. To identify the demographic characteristics of the respondents in terms of;
   - 1.1 Gender
   - 1.2 Age
   - 1.3 Qualifications under the education discipline
   - 1.4 Number of years at work.
2. To determine the extent of internal audit in money transfer companies.
3. To determine the level of fraud in selected money transfer companies.
4. To establish if there are significance relationship between internal audit function and fraud detection.

Research Questions

This study sought to answer the following research questions:

1. What are the demographic characteristics of the respondents as to:
   - 1.1 Gender?
   - 1.2 Age?
   - 1.3 Qualifications under the education discipline?
   - 1.4 Number of years working experience?
2. What is the extent of internal audit in money transfer companies?
3. What is the level of fraud (fraudulent financial reporting and misappropriation of asset) in money transfer companies?
4. Is there a significant relationship between internal audit and fraud detection?

Hypotheses

H_0 There is no significant relationship between internal audit and fraud detection (in terms of fraudulent financial reporting and asset misappropriation) in selected money transfer companies in Puntland, Somalia.

Scope

Geographical Scope

This study took place in Somalia particularly in Puntland the researcher only focused on selected six money transfer companies namely (Dahabshil, Amal, Iftin, Mustaqbal, Tawakal and Kaah) of the 20 money transfer companies currently operating in Puntland especially the three big and most populated cities Garowe, Galkaio and Bosaso.

Content Scope

The study investigated the extent of internal audit, level of fraud detection and cause and effect relationship between the independent variable (internal audit) and dependent variable (fraud detection).

Theoretical Scope

As stated in the work of Berle and Means (1932) and Jensen and Meckling (1976), Agent Theory concerning the relationship between a principal (shareholder) and an agent of the principal (company's managers) the study was confined to the Agent Theory to explain the effect of the internal auditor's ability to assess the fraud risk on his/her ability to detect the likelihood of fraud.

Significance of the Study

This study is significant to different categories of stakeholders, including:

The owners or shareholders of Money transfer companies in Puntland will benefits from the findings of the study in the sense that they was come up with effective fraud detection strategies, and will also understand the fraud attached to their organizations.

The management and staff in the money transfer sector will also benefit from the findings of this study as they will understand the reasons of fraud detection policies and strategies and implementation of those strategies; it also help managers to develop functioning internal audit within their organization.

The findings of this study are beneficial to the government bodies in charge of auditing and accounting sector particularly the Accountant General and Auditor General. Upon this they will update about issues on policies of fraud detection of Money Transfer Companies and they can select priority areas for training internal auditors of money transfer companies in Puntland, Somalia as well as their staff.

It will also enlighten the people of Puntland who are either clients of the Money transfer companies or investors about the risks surrounding those companies.

Finally, this study may serve as a literature review to other researchers, and students conducting their academic studies in the area of fraud.

Operational Definitions of Key Terms

For the purpose of this study, the following terms are defined as they are used in the study:

Fraud

Fraud is an intentional act by one or more individuals among management, those charged with governance, employees or third parties, involving the use of deception to obtain an unjust or illegal advantage.

Internal Audit

Internal auditing is an independent and objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance process.

Fraudulent financial reporting

Involves intentional misstatement including omissions of amounts or disclosures in financial statement to deceive financial statement users. Misappropriation of assets

Asset misappropriation

Involves the theft of an entity's assets and it is often perpetrated by employees in relatively small and immaterial amounts.

CHAPTER TWO

REVIEW OF RELATED LITERATURE

Concepts, Opinions, Ideas from Authors/Experts

Internal Audit

Courtemanche (1986) states that until recently, there were two basic conceptions of internal auditing: the traditional and the modern. The traditional conception of internal auditing views accounting as its true discipline, accounting control as its true concern and the board's audit committee as its true client. The modern conception of internal auditing does not reject the substance of the traditional conception, but seeks to extend it beyond its narrow confines. Modern internal auditing claims an unlimited scope, reserves the freedom to borrow from many disciplines and recognizes senior management as additional clients more or less distinct from the board's audit committee.

According to Gleim (2004), internal auditing is a management-oriented discipline that has evolved rapidly since the Second World War. Once a function primarily concerned with financial and accounting matters, internal auditing now addresses the entire range of operating activities and performs a correspondingly wide variety of assurance and consulting services. The development of internal auditing was fostered by the increased size and decentralization of organizations, the greater complexity and technological sophistication of their operations, and the resulting need for an independent, objective means of evaluating and improving their risk management, control and governance processes.

Gleim (2004) provides the official IIA definition with its source: internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance.

The development of internal auditing

Pickett (2005) is of the opinion that internal auditing is now a fully developed profession. An individual employed in internal audit ten years ago would find an unrecognizable situation in terms of internal audit's role, the services provided and the approach followed. For full appreciation of internal auditing, it is necessary to trace these developments back and extend trends into the future. It is important to understand the roots of internal auditing and the way it has developed over the years. Internal auditing developed as an extension of the external auditing role in testing the reliability of accounting records that contribute to published financial statements.

Cascarino and Van Esch (2005) state that the profession of internal auditing, as many other professions, has its roots in the Industrial Revolution of the nineteenth century. The enormous growth of the business sector found existing professionals scrambling to keep up. Specialists appeared, coping with such innovations as corporate law, banking provisions and bankruptcies.

This led to the formation of a plethora of organizations and associations that, over a period of time, amalgamated into the British Institute of Chartered Accountants and the American Certified Public Accounts in their respective countries.

The main difference between the two bodies at that time was the method of achieving professionalism in the bodies. The American body adopted a style that combined the academic and business worlds, and produced professionals that were a hybrid of both. The British institute took the more traditional English path of a trade apprenticeship outside the tertiary education system. This situation continued into the mid- 1950s, with the two institutes dominating the business world in those countries and becoming an increasingly integrated part of corporate life, to the extent that almost half of all qualified professional accountants were employed outside audit firms.

By the start of the 1940s, professional internal control evaluators were employed by and distributed throughout organizations to such an extent that the differentiation between internal and external auditor became a meaningful concept.

The statutory role of the external auditor has remained the attestation function, confirming that the financial records of organizations have been fairly presented.

The role of the internal auditor has developed over the past 70 years to one of assisting management in the discharge of its responsibilities by ensuring that the internal control structures are appropriate to a given level of risk and function, as management intended. Increasingly, internal auditors are called upon to act as internal control, risk and corporate governance consultants within organizations.

In 1941, the Institute of Internal Auditors Inc. (IIA) was formed. Based in New York, it was confined to America only. Its role was to provide a clearing house for ideas and education, and generally to unite the developing profession. After World War II, the growth in multinational corporations virtually guaranteed the spread of the IIA to the rest of the industrialized world. It was not only the IIA that expanded.

External audit firms formed working agreements with other firms across national boundaries, which eventually led to large international partnerships.

By the 1960s, the IIA had grown and flourished, becoming the acknowledged international leader of the internal auditing profession. From the IIA's inception, it was recognized that the multidisciplinary and evolutionary nature of the business world would have to be reflected in the IIA.

It therefore had to provide the umbrella beneath which individual skills and talents needed to audit the internal control mechanisms of modern business could come together as equals to share knowledge and grow in the process.

Internal Audit responsibility

The Institute of Internal Auditors (IIA) has developed a globally accepted definition of internal auditing as an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes IIA (2004). In other words, the internal audit basically is to deal with fraud and red flags. Indeed.

IIA summarizes the expectations of internal auditors concerning the deterrence, prevention, detection, and reporting of fraud. In 1997, IIA issued Statement of Auditing Standard (SAS) No. 82 on the function of internal auditors. In its report The Consideration of Fraud in a Financial Statement Audit, IIA emphasized that internal auditors should have sufficient knowledge of fraud to be able to identify indicators (red flags) that fraud might have been committed. This statement identified 25 red flags (risk factors) that auditors should pay attention to as indicators that fraudulent activity is very possible. In 2002, SAS No. 99 required external auditors to use 42 red flags in financial statement audits to detect fraudulent financial reporting. This issue moves expectations from "I believe management" to "I don't believe management".

It is true that the major reason for instituting internal control measures such as internal checks and internal audit is to prevent and/or discourage fraud Arens et al. (2006). The auditing of financial statements fraud involves intertwining auditing processes among the internal, committee, and external. They work with each other to achieve efficient auditing. The audit committee plays an important role in auditing of financial statements fraud. Abbott et al. (2000), Beasley et al. (2000), and Robinson (2002) identify a relationship between the independence of audit committee members and the incidence of fraud. Skouen and Wright (2006) found that as the proportion of audit committee members who are independent increases, the probability of financial statement fraud decreases. They define an independent audit committee member as a member who is not a current employee of the firm, former officer or employee of the firm or related entity, a relative of management, professional advisor to the firm, officers of significant suppliers or customers of the firm, interlocking director, and/or one who has no significant transactions with the firm Robinson (2002).

Dechow et al. (1996) determine that the incidence of fraud is highest among firms with weak corporate governance systems. They find that fraud firms are more likely to have boards dominated by insiders and are less likely to have an audit committee. Beasley (1996) notes that the incidence of financial statement fraud decreases as the number of outside members and outside member tenure on the audit committee increase. This is consistent with the observation made by Abbott et al. (2000) who found an inverse relationship between the level of audit committee independence and the incidence of fraud. Beasley et al. (2000) observe a reduced incidence of fraud among companies having an audit committee. Additionally, larger audit committees are associated with a lower incidence of fraud Beasley et al. (2000). Expansion in the number of independent members on the audit committee, on the other hand, is negatively related to the occurrence of fraud Skouen et al. (2008). Finally, Dunn (2004) concludes that fraud is more likely to occur when there is a concentration of power in the hands of insiders.

Moyes et al. (2006) pointed that internal auditors, who are aware of the pressure to achieve financial goals, should recommend to the audit committee to reduce or eliminate unobtainable financial goals. The internal auditors should report to the audit committee their concern regarding directors/managers who exercise undue influence/control as owners or creditors.

Any auditor who fails to recognize red flags will most likely be held negligent AccountingMalpractice.Com (2004). On the other hand, auditors who cannot communicate effectively with the audit committee must be prevented from reporting fraudulent occurrences to the audit committee. Any restrictions on internal auditors to interview managers, examine records or communicate with the audit committee are perceived by internal auditors as highly indicative of fraudulent activity. These restrictions might prevent the internal auditors from collecting and analyzing enough evidence necessary to determine whether fraud exists. The internal auditing director should request a written contract known as a charter, which is authorized by the audit committee and describes the responsibilities and the independence of the internal auditors. Moyes et al. (2006) argue that internal auditors should report the problem of domineering managers to the audit committee. They should also encourage audit committees to implement missing internal controls or improve the effectiveness of existing controls. If organizations are secretive and disclose inadequate information internally to employees and externally to the general public, the internal auditors should convince the audit committees to establish a new company policy to disclose more adequate information to all interested parties, both internal and external. SAS No. 99's adoption of the fraud risk factor framework requires auditors to attempt to detect the presence of fraudulent behavior by comprehensively assessing the extent to which pressure, opportunity and rationalization are present Skouen et al. (2008). While rationalization is a necessary component of the fraud triangle, an individual's rationale is difficult to observe. Extant research indicates that the frequency of audit failure and litigation increases immediately after a change in auditor Loebbecke et al. (1989); Stice, (1991); St. Pierre & Anderson (1984). Rationalization is the third leg of the fraud triangle and the most difficult to measure.

SAS No. 99 requires external auditors to use red flags in financial statement audits, and internal auditors also to use them in conducting operational, compliance and financial statement audits Moyes al et. (2006).

The Practice Advisory 1210.A2-2.2: Responsibility for Fraud Detection IIA, (2004) stresses that internal auditors have a responsibility to exercise "due professional care" with respect to fraud detection. Internal auditors should have sufficient knowledge of fraud to identify the indicators (red flags) that fraud may have been committed, be alert to opportunities that could allow fraud, evaluate the need for additional investigation, and notify the appropriate authorities. In other words, like external auditors, internal auditors should know the level of fraud-detecting effectiveness of each red flag Moyes et al. (2006). The effectiveness and value of internal audit within organizations should also warrant to be examined since most of prior research has just focused on perceptions from external auditors in this area Coram et al. (2006).

Auditing Standard No. 65 AICPA (2003) describes the competence and objectivity requirements for internal auditors to provide real assistance to external auditors in performing financial statement audits, in addition to conducting their own financial audits of different areas of the accounting system. As such, internal auditors have as much professional interest in using red flags to detect fraud as external auditors do Moyes et al. (2006).

Both internal and external auditors emphasize the importance of fraud assessment and detection partly in response to calls by professional bodies, regulatory agencies, and governments. Both external and internal auditors will logically challenge management's use of a non-Generally Accepted Accounting Principles (Non-GAAP), unless management and the auditors can justify the use of such non-GAAP on the basis of a better measurement of either net assets or net income. Whenever corporate management selects any non-GAAP solely for the purpose of income tax reduction, the internal auditors along with the external auditors should always investigate for the justification for using the non- GAAP Moyes et al. (2006). Apostolou et al. (2001) questioned both internal and external auditors regarding the importance of twenty five red flags found in SAS No. 82. The highest rated indicators were management characteristics and influence over the control environment. However, no significant differences were noted between internal and external auditors regarding the weighting of importance Moyes et al. (2006). Internal auditors along with the external auditors should negotiate with non-financial management to adopt a GAAP to replace the non-GAAP. If non-financial management refuses, both internal and external auditors can write audit reports to the audit committee.

Audit opinions from internal and external auditors should convince the audit committee to direct non-financial management to adopt the appropriate GAAP Moyes, et al. (2006). When the internal audit function is wholly outsourced, those conducting the audit have less opportunity to get to know the organization and as such are less likely to detect frauds such as asset misappropriation Coram et al. (2006). The effectiveness of the work of the internal auditor is evaluated on how well they detect or prevent actual errors within an organization. The number and magnitude of errors requiring adjustment by the external auditor have been found to be substantially lower for entities that had an internal audit department compared to those that did not have an internal audit department Wallace & Kreutzfeldt (1991).

The internal audit function is an important function that has been shown to add value Carey et al. (2000); Carcello et al. (2005) and reduce detected errors by external auditors Wallace & Kreutzfeldt (1991). Internal audit function objectives are to improve the effectiveness of risk management, control, and governance IIA (1999). This function is considered an important governance tool to protect corporations from internal criminal behavior Nestor (2004). When considering fraudulent financial reporting internal auditors think that fraud is the reason for an unexpected difference in income when (1) income is greater than expected and (2) when debt covenants are restrictive conditioned on income being greater than expected Church et al. (2001). Moyes et al. (2006) argue that internal auditors should always investigate disagreements between predecessor and current external auditors, since such disagreements between external auditors may point to potential fraudulent activities. That it is now the responsibility of the auditor not only to prevent but also to detect fraud. Moyes et al. (2006) further assert that it is conceivable that accountants and auditors may misuse or apply no new standards in financial reporting when they do not understand the new accounting and auditing standards. Professional development conferences and classes are important today for accountants, external auditors and internal auditors to remain updated with all of the new standards. They contend that internal auditors should:

- Recommend to the audit committee either the implementation of missing key internal controls or the improvement in operating effectiveness of existing weak internal controls;
- Recommend to the audit committee the importance of correcting the reportable conditions to prevent and detect future fraud;
- Always review how management and accountants use the materiality principle in recording questionable transactions;
- Vigorously investigate revenue and expenses to determine if their balances are reasonable in amount when management has been subjected to aggressive and unrealistic forecasts from analysts;
- State in their reports to the audit committee, that auditors have inadequate time to collect and analyze enough evidence to determine if fraudulent financial reporting activities are occurring;
- Consider other employment in order to protect their professional careers and certifications, If the audit committee does not eliminate the unreasonable time constraints;
- Investigate revenue accounts to determine if their balances represent reasonable amounts, When internal auditors suspect management is falsely overstating revenue to increase profitability and stock prices; and
- Know which red flags are more effective in detecting fraud, so they can use these more effective red flags on a regular basis to collect stronger evidence to support writing better audit reports and know which red flags are less effective in detecting fraud, so they only use these less effective red flags infrequently as the basis for writing audit reports.

Fraud

Fraud has increased considerably over the recent years and professionals believe this trend is likely to continue.

According to Brink and Witt (1982), fraud is an ever present threat to the effective utilization of resources and it will always be an important concern of management.

Fraud has been broadly defined. ISA 240 'The Auditor's Responsibilities to Consider Fraud in an Audit of Financial Statement (Revised)' refers fraud as "an intentional act by one or more individuals among management, those charged with governance, employees or third parties, involving the use of deception to obtain an unjust or illegal advantage".

KPMG Forensic Malaysia (2005), in their Fraud Survey 2004 defines fraud as "a deliberate deceit planned and executed with the intent to deprive another person of his property or rights directly or indirectly, regardless of whether the perpetrator benefits from his/her actions".

Weirich and Reinstein (2000), define fraud as "intentional deception, cheating and stealing". Some common types of fraud include creating fictitious creditors, "ghosts" on the payroll, falsifying cash sales, undeclared stock, making unauthorized "write-offs", and claiming excessive or never-incurred expenses.

Pollick (2006), regards fraud as a "deliberate misrepresentation, which causes one to suffer damages, usually monetary losses". According to Pollick, most people consider lying as fraud, but, in a legal sense, lying is only one small element of actual fraud.

Albrecht et al (1995), classified fraud into "employee embezzlement, management fraud, investment scams, vendor fraud, customer fraud, and miscellaneous fraud". Fraud also involves complicated financial transactions conducted by white collar criminals, business professionals with specialized knowledge and criminal intent Pollick (2006).

According to Black Law Dictionary cited in Lawrence et al (2004), fraud also means "taking advantage over another person by providing false, misleading suggestions, or by suppression of the truth". Therefore, fraud is not restricted to monetary or material benefits. It includes intangibles such as status and information.

In the Anti-fraud policy in Murdoch University (2001), fraud is described as "...inducing a course of action by deceit or other dishonest conduct, involving acts or omissions or the making of false statements, orally or in writing, with the object of obtaining money or other benefits from or by evading a liability".

According to MacDonald (1993), there are no actual definitions of fraud and error since the dividing line where error crosses into fraud is based on the psychological construct of intent.

MacDonald argues that fraud is a legal term, which applies when intent can be proven in a court of law. However, Pollick (2006) claims that fraud is not easy to prove in a court of law as the accuser must be able to demonstrate that the accused had prior knowledge and had voluntarily misrepresented the facts.

From a legal point of view, according to the definition given by Mr. Alexandru Boroi in his Dictionary of Criminal Law", fraud is defined as cheat, misguidance, and delusion for profit purposes by inducing damage.

Mr. Mircea N. Costin, in his "Dictionary of Civil Law", defines fraud as an intentional violation by the parties of the mandatory provisions of the legislation in force, often by using perfidious means, at the conclusion or execution of a legal act.

Asset misappropriation

According to the 2008 Report to the Nation on Occupational Fraud and Abuse, asset misappropriation can be categorized according to different scheme types, including: skimming, cash larceny, fraudulent disbursements, and non-cash larceny and misuse ACFE (2008).

Skimming includes those acts where funds are taken by the perpetrator before the funds have been recorded in the organization's financial records. Skimming may occur at the point of sale, from receivables, or from refunds. Cash larceny refers to fraudulent acts that involve the theft of funds after they have been recorded. The cash is typically stolen from the cash on hand, such as from the cash register or petty cash, or taken from a deposit.

Fraudulent disbursements cover a wide variety of schemes: 1) Billing schemes typically involve employers making payments based on false invoices for personal purchases; 2) Check tampering refers to altering or forging an organization's check for personal use; 3) Expense reimbursements include false claims of fictitious business expenses; 4) Payroll schemes resemble billing schemes in that payment is based on false documentation, such as timecards, which indicated that compensation is fraudulently due to an employee; and 5) Cash register disbursements entail false entries or "no sale" transactions to hide the removal of cash.

Finally, non-cash misappropriations involve those schemes where employees steal or misuse the non-cash assets of the organization, such as inventory or equipment, for their own personal benefit

Fraud Detection

Fraud detection has been considered a major purpose of auditing for very long time. Gupta and Ray (1992) note the literature an internal auditing that shows fraud discovery to have been central in both medieval early modern times. Flesher, Previts, and Samson, in their review of American auditing since the earliest colonial days (2005), describe an activity suffused with the intent to detect financial misconduct.

The role of auditors has not been well defined from inception Alleyne & Howard (2005). Porter (1997) reviews the historical development of the auditors' duty to detect and report fraud over the centuries. Her study shows that there is an evaluation of auditing practices and shift in auditing paradigm through a number of stages.

Porter study reveals that the primary objective of an audit in the pre-1920's phase was to uncover fraud. However, by the 1930's, the primary objective of an audit had changed to verification of accounts. This is most likely due to the increase in size and volume of companies' transactions which in turn made it unlikely that auditors could examine all transactions. During this period, the auditing profession began to claim that the responsibilities of fraud detection rested with the management. In addition, management should also have implemented appropriate internal control systems to prevent fraud in their companies.

In the 1960's, the media and public were generally unhappy that auditors were refusing to accept the duties of fraud detection. The usefulness of an audit was frequently called into question as they generally failed to uncover fraud. However, despite the criticism, auditors continued to minimize the importance of their role in detecting fraud by stressing that such duty rested with the management. Due to the advancement of technology in the 80's, the complexity and volume of incidents of fraud have posed severe problems for businesses. Porter (1997) asserts that, even though the case law has determined that in some circumstances auditors have a duty to detect fraud, the courts have attempted to maintain the auditors' duties within reasonable limits. In contrast, Boynton et al (2005) argue that since the fall of Enron, auditing standards have been revamped to re-emphasise the auditors' responsibilities to detect fraud. Their assertion is based on ISA 315 'Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement' and ISA 240 'The Auditor's Responsibilities to Consider Fraud in an Audit of Financial Statement (Revised)'.

ISA 315 requires auditors to evaluate the effectiveness of an entity's' risk management framework in preventing misstatements, whether through fraud or otherwise, in the course of an audit. Boynton et al (2005) stress that this requirement was not previously necessary. They further explain that such an evaluation was only required previously when they chose to place reliance on that framework and to reduce the extent of the audit investigation. In addition, all staff members engaged on an audit are now required to communicate their findings with each other, to prevent situations where staff members, working independently on their own sections of the audit, have failed to appreciate the significance of apparently minor irregularities that, if combined, take on a more sinister meaning.

Additionally, Boynton et al (2005) claim that auditors are required to be more proactive in searching for fraud during the course of an audit under ISA 240 (Revised). Their duties now include considering incentives and opportunities presented to potential fraudsters, as well as rationalizations that the fraudulent act is justified. Auditors are also expected to inquire more closely into reasons behind such matters as, for example, errors in accounting estimates, unusual transactions that appear to lack business rationale, and a reluctance to correct immaterial error.

Theoretical Perspectives

As in the work of Berle and Means (1932) and Jensen and Meckling (1976), Agency theory is adopted in this study to explain the effect of the internal auditor's ability to assess the fraud risk on his/her ability to detect the likelihood of fraud.

The essential concern of corporate governance arises from the separation of ownership and control in modern public corporations. This is the essence of the agency theory as argued by early scholars such as Berle and Means (1932) and Jensen and Meckling (1976). Under this concept the responsibility of control is vested in the board and management, the agents of the shareholders. The board who only meets a few times a year in turn appoints management (as their agents) headed by the Chief Executive Officer to manage the organization. While the independent external auditors provide an assurance to the shareholders as to the overall satisfactory performance of the board and management, it is the independent internal auditors who provide an assurance to the board as to the satisfactory performance of management by detecting the likelihood of fraud in the organization. Agency theory in this context provides the basis to explain the independent role and responsibilities assigned to the internal audit function Adams (1994).

The concern of shareholders as a result of this agency theory has been strengthened over time especially through the government's and professional body's response to recent corporate scandals. The world has addressed this through a range of changes to accounting standards, ethical guidelines and statutory legislative requirements that directly enhances the independence of the external auditor. These changes also indirectly imply a strengthened independent role of the internal auditor.

Related Studies

From the analysis of the literature, the auditor's experience has been found in many studies. Moyes and Hasan (1996) and Owusu-Ansah et al. (2002) both utilized the audit procedures to examine the likelihood detection of fraud. In the study of Moyes and Hasan (1996), they required the subjects to evaluate the effectiveness of auditing techniques associated with 4 audit cycles: acquisition and payment, inventory and warehousing, payroll and personnel and sales and collection in detecting fraud. Meanwhile, Owusu-Ansah et al. (2002) assessed the fraud-detecting effectiveness of audit procedures that are applicable only to the stock and warehouse cycle. More importantly, Moyes and Hasan (1996) and Owusu-Ansah et al. (2002) both tested similar factor, which was the size of the audit firm. In their study, Moyes and Hasan (1996) demonstrated that size does not play a significant role in the likelihood of detecting management fraud, except for the inventory cycle. Interestingly, this result confirms the findings of Owusu-Ansah et al. (2002), who also investigated the likelihood of detecting fraud in the inventory cycle.

"Study on Fraud and error auditors' responsibility level"

This study explores the financial report users' perceptions of the extent of fraud in Romania and of auditors' responsibilities in detecting fraud. It also investigates the perceived extent of the related audit procedures. The study also aims to ascertain whether the report users' perceptions of the auditors' responsibilities on fraud detection is consistent with the Romanian auditing professions' published standards.

The study found that respondents are very concerned about the problem of fraud in Romania. In addition, the results show that respondents' perceptions of the official objective of an audit are incorrect, as they placed a very high expectation on auditors' duties on fraud prevention and detection. This perception is in sharp contrast with the stated primary objective of an audit, as stipulated in ISA 200, which merely required auditors to form an opinion on the financial statement, but not of fraud prevention and detection efforts of the company. Such a change is explained by the shift in auditing paradigm highlighted by Porter (1997).

ISA 240 The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements makes it clear that the responsibility for the prevention and detection of fraud and error rest with management, through the implementation and continued operation of adequate accounting and internal control systems. Such systems reduce but do not eliminate the possibility of fraud and error. In contrast, the auditor is not and cannot be held responsible for the prevention of fraud and error. The fact than an annual audit is carried out may, however, act as deterrent. The auditor must therefore seek sufficient appropriate audit evidence that any fraud or error which may be material to the financial statements have not occurred. If it has occurred, the auditor must ensure that the effect of fraud is properly reflected in the financial statements or the error is corrected. Because of the inherent limitations of an audit, there is an unavoidable risk that material misstatements in the financial statements, resulting from fraud or (to a lesser extent) error, may not be detected. Where such a misstatement is detected after the audit, the auditor will only have failed to adhere to basic principle and procedures if it is found that the audit procedures undertaken were not adequate in the given circumstances.

The study also found a lack of understanding among respondents of the statutory duties of auditors. The lack of understanding is because the users may not have read the statutory provisions for auditors, or have chosen to ignore or forget them.

The present situation may be improved through several strategies, the two most likely to succeed being: i) educating the users on the role and the actual duties of auditors, through better communication by auditors; and ii) by expanding the scope of the audit to meet market expectations. Porter (1997) believes that education may help in solving the misconception problem as it may reduce the "misunderstanding gap" caused by ignorance. On the other hand, expanding the scope of an audit may help to mitigate the "expectation gap" problem as auditors would then be performing additional duties not previously required. It is hoped that by implementing both approaches, the public's expectation and auditor's duties will be brought into closer accord

Corem et al (2006) conducted a study in Australia the study basically assessed the value of internal audit function in detecting the fraud within organization, It also evaluates differences in the effectiveness of fraud detection between organizations that choose between different internal audit approaches such as: internal audit function within the organization (in sourcing); outsourcing; and a combination of both.

The results found that there is a significant positive relation between an organization having an internal audit function and the number and value of self-reported frauds. For those organizations with internal audit, partial or full in sourcing increased the likelihood of fraud detection when compared with organizations that outsource the entire function.

CHAPTER THREE

METHODOLOGY

Research Design

This study is quantitative in approach and it used a descriptive comparative and descriptive correlation design. Descriptive studies are non-experimental that describe the characteristics of a particular individual, or of a group. The descriptive comparative design was used to compare the extent of internal auditor to the level of fraud detection in selected money transfer companies in Puntland, Somalia. It also followed descriptive correlation design to establish whether there is a significant relationship between the extent of internal audit and the level of fraud detection in selected money transfer companies in Puntland, Somalia; descriptive correlation design deals with the relationship between variables, testing of hypothesis and development of generalizations and use of theories that have universal validity.

Research Population

In this study the researcher selected 6 money transfer companies from currently 20 money transfer companies operating in Puntland. The population of this study was comprised of senior management, financial controllers, accountants, cashiers and internal auditors in which consist a population of 149. The reason for selecting this type of people was due to the fact that the researcher expected them to have a very good understanding of the internal audit function of fraud detection.

Sample Size

Out of the total population of 149, a sample size of 109 was selected, using Sloven's formula. The sample is sufficiently high and representative enough to validate the findings, so the findings of this study can be replicated the whole population. The table below can give you the selected population their respective organization and city.

$$n = \frac{N}{1+N(e^2)}$$

Where, n= sample; N=target population; α=constant variable: equivalent to 0.05, which is the allowed margin of error.

Table 1

Respondents of the Study

Town / Organization	Bosaso	Garowe	Galkaio	Population	Sample
Dahabshiil	12	10	10	32	23
Amal	10	8	13	31	23
Iftin Expr	10	6	9	25	18
Kaah	8	6	7	21	15
Tawakal	8	6	5	19	14
Mustaqbal	8	6	7	21	15
Total	**56**	**42**	**51**	**149**	**109**

Therefore given the formula, the sample size of 109 was calculated as follows;

$n = \frac{N}{1+N(e^2)}$

$= \frac{149}{1+149(0.0025)}$

$= \frac{149}{1+0.3725}$

$= \frac{149}{1.3725}$

$= 108.561$

≈ 109

Sampling Procedure

The study employed purposive sampling technique to select respondents from the six money transfer companies to include in the sample. This technique involves where the researcher uses his or her own judgment or common sense regarding the participant from whom information are collected.

Research Instruments

The implementation of this study was used questionnaire as the main tool to collect data. The study employed three research tools, the face sheet which was used to collect data on the profile of respondents; and two research made questionnaires, one questionnaire focused on the independent variable, that is internal audit, and the other questionnaire focused on the dependent variable that is, fraud detection.

Validity and Reliability of the Instruments

Content validity was ensured by subjecting the researcher devised questionnaires on resource availability and utilization to judgment by the content experts who estimated the validity on the basis of their experience and knowledge toward subject.

The individuals made their judgments about the relevance of the items.
The CVI was

established using the formula: $CVI = \dfrac{\text{No of Item declared valid by the judges}}{\text{Total No of items on the questionnaire}}$

Internal audit = 15/17 = 0.88

Fraudulent financial reporting = 7/9 = 0.78

Misappropriation of asset = 6/7 = 0.86

The results of the CVI are shown in Table 2 A below

Table 2 A:

CVI results

Variable	**Number of items**	**CVI**
Internal Audit	15	0.88
Fraudulent financial reporting	7	O.78
Misappropriation of asset	6	0.86

Source: Primary data

Table 2 A above shows that internal audit was measured using 15 items and yielded CVI of 0.88 while fraudulent financial reporting was measured using 7 items and yielded a CVI of 0.78 yet misappropriation of asset was measured using 6 items and yielded a CVI of 0.86. Since all variable yielded a CVI above 0.70 accepted for social sciences, it was concluded that the instrument had a good validity hence relevant

To ensure reliability, the two instruments were pre-tested by administrating them to 3 money transfer companies and 20 respondents. Pre-testing for reliability helped to reveal; 1) problem relating to answering, completing or returning the questionnaire; and 2) weaknesses in the administration, organization and distribution of the questionnaire. Reliability of data collected was tested using Cronbach's coefficient Alpha (α), computed using SPSS. The results are in table 2 B below;

Table 2 B:

Cronbach's Alpha Value

Variable	Number of Items	Cronbach's Alpha Value
1. Internal Audit	9	.856
2. Fraud		
2 A. Fraudulent Financial Reporting	6	.921
2 B. Asset Misappropriation	5	.897

Results in table 2 B indicates that the instrument had a high degree of reliability, with all Cronbach's alphas for all items greater than 0.8, which according to Amin (2005) is the minimum Cronbach's alpha required to declare the instrument reliable.

Data Gathering Procedures

Before the administration of the questionnaires

An introduction letter is obtained from the College of Higher Degrees and Research for the researcher to solicit approval to conduct the study from respective senior management, accountants, internal auditors, cashiers and financial controllers of money transfer companies. When approved, the researcher secured a list of the qualified respondents from the in charge and select through purposive sampling from this list to arrive at the minimum sample size. The respondents explained about the study and requested to sign the Informed Consent Form.

The research then produced over 120 copies of the questionnaire and sat all research assistants, discussed and briefs them on the sampling technique and data gathering procedures.

During the administration of the questionnaires

Specifically, the researcher and the assistants requested the respondents the following: (1) to sign the informed consent; (2) to answer completely all questions and not to leave any item of the questionnaires unanswered; (3) to avoid biases and to be objective in answering the questionnaires. Some respondents had to be guided on what to do by data collectors and as such, some questionnaires were retrieved on spot, while others were retrieved after some days or weeks. All questionnaires retrieved were checked if completely filled out.

After the administration of the questionnaires

On their return, the researcher edited and entered the questionnaire responses into the SPSS package, for further processing and analysis. Finally, a report was prepared and after approval from the supervisor, the final copy was submitted to CHDR for final examination.

Data Analysis

To analyze data, SPSS statistical software was used because this type of software is good for primary data to analyze and the data that the researcher analyzed were primary data.

1. To analyze the objective one of this study the researcher used frequency and percentage distribution table.
2. Analyzing objectives two and three the researcher used to investigate the mean which tells the researcher the highest and the lowest levels of Internal Auditor as independent Variable and fraud detection as dependent variable.

   The following mean ranges were used to arrive at the mean of the individual indicators and interpretation:

   A. extent of Internal Audit

Mean Range	*Description/Response Mode*	*Interpretation*
3.26-4.00	strongly agree	Very satisfactory
2.51-3.25	agree	satisfactory
1.76-2.50	disagree	fairly satisfactory
1.00-1.75	strongly disagree	Poor satisfactory

   B. *Level of Fraud*

Mean Range	*Description/Response Mode*	*Interpretation*
3.26-4.00	strongly agree	Very satisfactory
2.51-3.25	agree	satisfactory
1.76-2.50	disagree	fairly satisfactory
1.00-1.75	strongly disagree	Poor satisfactory

3. The Pearson's Correlation Coefficient was used to determine the relationship between internal audit and fraud detection

Ethical Considerations

To ensure confidentiality of the information provided by the respondents and to ascertain the practice of ethics in this study, the following activities were implemented by the researcher:

1. All questionnaires coded to provide anonymity of respondents responses.
2. Solicit permission through a written request to the concerned officials of the companies included in the study.
3. Respondents were requested to sign the Informed Consent Form (Appendix III)
4. No respondents was threatened or coerced to participate.
5. Authors quoted were fully recognized through citation and referencing
6. Presented the findings in a generalized manner.

Limitations of the Study

In view of the following threats to validity, the researcher claimed an allowable (0.05 level of significance) 5% margin of error. Measures are also indicated in order to minimize if not to eradicate the threats to the validity of the findings of this study.

2. Instrumentation: The research instruments on internal audit and fraud detection are not standardized. Therefore a validity and reliability test was done to produce a credible measurement of the research variables.

3. Testing: The use of research assistant brought about inconsistency in the administration of the questionnaires in terms of time of administration, understanding of the items in the questionnaires and explanations given to the respondents. To minimize this threat, the research assistants was oriented and briefed on the procedures done in data collection.

4. The researcher encountered constraints to access the respondents especially staff of the Money transfer companies due to their tight, busy schedules arising from their job responsibility and strict protocol of those companies.

CHAPTER FOUR

PRESENTATION, ANAYLAYSIS, AND INTERPRETATION OF DATA

Profile of Respondents

The first objective of the study was to determine the profile of Money Transfer Companies' staff namely senior management, Accountants, Internal Auditors, Financial controllers and cashiers and to achieve it; closed ended questions were asked in the questionnaire. Frequencies and percentage distributions were used to summarize the profile selected employees in selected money transfer companies in Puntland in terms of Gender, educational level, age, years in work as indicated in Table 3 below.

Table 3

Profile of the respondents

Major Category	Sub-Category	Frequency	Percent
Sex	Male	95	87.2
	Female	14	12.8
	Total	**109**	**100.0**
Age Group	20-39	62	56.9
	40-59	45	41.3
	60-Above	2	1.8
	Total	**109**	**100.0**
Education Level	Secondary	16	14.7
	Diploma	22	20.2
	Bachelor	55	50.5
	Master	16	14.7
	Ph.D	0	0
	Total	**109**	**100.0**
Years in Work	Less than/Below	7	6.4
	2-3 Years	30	27.5
	4-6 Years	42	38.5
	7 years and	30	27.5
	Total	**109**	**100.0**

Source: Primary Data, 2012

Table 3 is for the profile of the respondents (gender, age, qualification and work experience). Table 3 shows that 87.2% of the respondents were male and 12.8% were female. This clearly shows that most employees of money transfer companies in Puntland, Somalia are male. The result indicates that there were more male than female individuals working in money transfer companies in Puntland. The gender distribution is not fairly evenly poised and we can therefore count gender-bias in the respondents.

The age part of Table 3 indicates that Majority (56.9%) of the respondents are less than 3 years of age, while 41.3% of the respondents are the age group 40-59, 1.8% of the respondents are above 59 years of age which is in line with most African countries where the biggest portion of the population lies below 35 years and very few are above 60 years. This study found that the money transfer company's staffs were of diverse age groups.

In terms of highest education qualification, results indicate that respondents in selected money transfer companies in Puntland are highly educated. Majority (50.5%) of the respondents has bachelor degree, 20.2% of respondents have diploma, while 14.7% of respondents have secondary certificates and 14.7% of respondents have master degree.

Finally concerning the number of years in work, results in Table 3 indicates that majority (38.5%) of the respondents worked for money transfer companies a period between 4 to 6 years, 27.5 % of respondents have been working 1 to 3 years and only 6.4% of the respondents have less than 1 year of work experience in selected money transfer companies.

The extent of internal audit in Money Transfer Companies in Puntland Somalia

The second objective of this research was to determine the extent of internal audit in money transfer companies in Puntland, Somalia. All questions were rated using a four point likert scale, were: 1= Strongly disagree, 2= disagree, 3= agree, 4= Strongly agree. The self-rating of respondents were analyzed using mean indicating the extent internal audit to which they recognize each as indicated in Table 4.

For interpretation of responses the following numerical value and description were followed:

Mean Range	*Description/Response Mode*	*Interpretation*
3.26-4.00	strongly agree	Very satisfactory
2.51-3.25	agree	satisfactory
1.76-2.50	disagree	fairly satisfactory
1.00-1.75	strongly disagree	Poor satisfactory

Table 4

Extent of Internal Audit in selected money transfer companies

(n=109)

Measures of internal Audit	**Mean**	**Interpretation**	**Rank**
The internal audit assess internal control used by the company to detect the fraudulent financial reporting and asset misappropriation	3.01	Satisfactory	1
The internal auditor assesses management's style, to determine if the style might lead to fraudulent financial reporting	2.97	Satisfactory	2
Has active participation in implementing fraud detection	2.94	Satisfactory	3
The internal auditor checks customer account for proper disclosure	2.89	Satisfactory	4
The work of internal audit and fraud detection are interrelated	2.89	Satisfactory	4
It is the responsibility of internal audit to uncover fraud to report this to the appropriate authorities	2.86	Satisfactory	5
The internal auditor checks conflict of interest in order to detect fraud	2.86	Satisfactory	5
The management of the company implements the findings of the internal audit	2.85	Satisfactory	6
Provides independent assurance on fraud detection	2.85	Satisfactory	6
The internal auditor review all returned bank statements for an appropriate period subsequent to the examination date	2.85	Satisfactory	6
The internal audit test bank account reconciliation for accuracy	2.84	Satisfactory	7
The internal auditor checks the monitoring and resolution of customer compliant	2.77	Satisfactory	8
people within the organization perceive internal auditor as their partner	2.77	Satisfactory	8
There is differences between internal audit and fraud detection	2.76	Satisfactory	9
Assist and advice, a new separate fraud detection function	2.72	Satisfactory	10
The internal audit function of the organization is independent	2.55	Satisfactory	11
Top management gives input for internal audit planning	2.41	Fair Satisfactory	12
Overall Mean Index	**2.81**	**Satisfactory**	

Source: Primary data, 2012

Results in Table 4 show that item analysis means indicate that the level of internal audit is satisfactory in terms of i)The internal audit assess internal control used by the company to detect the fraudulent financial reporting and asset misappropriation (mean =3.01); ii) The internal auditor assesses management's style, to determine if the style might lead to fraudulent financial reporting (mean =2.97); iii) Has active participation in implementing fraud detection (mean =2.94); iv) The internal auditor checks customer account for proper disclosure (mean =2.89); v) The work of internal audit and fraud detection are interrelated (mean =2.89); vi) It is the responsibility of internal audit to uncover fraud to report this to the appropriate authorities (mean =2.86); vii) The internal auditor checks conflict of interest in order to detect fraud (mean =2.86); viii) The management of the company implements the findings of the internal audit (mean =2.85); ix) Provides independent assurance on fraud detection (mean =2.85); x) The internal auditor review all returned bank statements for an appropriate period subsequent to the examination date (mean =2.85); The internal audit test bank account reconciliation for accuracy (mean =2.84); xi) The internal audit test bank account reconciliation for accuracy (mean =2.77); xii) people within the organization perceive internal auditor as their partner (mean =2.77); xiii) There is differences between internal audit and fraud detection (mean =2.76); xiv) Assist and advice, a new separate fraud detection function (mean =2.72); xv) The internal audit function of the organization is independent (mean =2.55); xvi) whereas the level of internal audit is fairly satisfactory in terms of only one item which is Top management gives input for internal audit planning (mean =2.41).

However, the overall mean index of the level of internal audit is satisfactory (overall mean index 2.81); we can say that the level of internal audit in selected money transfer companies is relatively satisfactory. This confirms that selected money transfer companies in Puntland, Somalia have satisfactory internal audit.

The level of the fraud detection in selected Money Transfer companies in Puntland Somalia.

The third objective of this research was to determine the level of fraud detection in selected Money Transfer Companies in Puntland, Somalia. All questions were rated using a four point likert scale, were: 1= strongly disagree, 2= disagree, 3= agree, 4= strongly agree. The self-rating of respondents were analyzed using mean indicating the level of fraud detection to which they recognize each as indicated in Tables 5 A and 5 B.

Table 5 A

Level of fraudulent financial reporting in selected money transfer companies (n=109)

Measures of Fraud	**Mean**	**Interpretation**	**Rank**
FRAUDULENT FINANCIAL REPORTING			
The potential of material misstatement is explicitly considered in detect fraud	3.02	Satisfactory	1
Action are taken to address risk to the achievement of financial reporting objectives	2.98	Satisfactory	2
The organization practically apply a set of fraud detected policies to maintain sound financial	2.94	Satisfactory	3
Fraud relevant to organization financial reporting have been managed	2.92	Satisfactory	4
The organization has fraud related to financial reporting	2.85	Satisfactory	5
When fraudulent activity is present or suspected, specialized internal audit activities may be	2.83	Satisfactory	6
Fraud is systematically identified	2.79	Satisfactory	7
There is any official statistics about the fraudulent financial reporting cases in this	2.69	Satisfactory	8
Fraud is a major concern for the company	2.39	Fairly Satisfactory	9
Average Mean Index	**2.82**	**Satisfactory**	

Source: Primary Data, 2012

Results in Table 5 A show that item analysis means indicate that the level of fraud detection related to fraudulent financial reporting is satisfactory in terms of i) potential of material misstatement is explicitly considered in detect fraud (mean =3.02); ii) Action are taken to address risk to the achievement of financial reporting objectives (mean =2.98); iii) The organization practically apply a set of fraud detected policies to maintain sound financial reporting (mean =2.94); iv) Fraud relevant to organization financial reporting have been managed (mean =2.92); v) The organization has fraud related to financial reporting (mean =2.85); vi) When fraudulent activity is present or suspected, specialized internal audit activities may be performed to assist management in detecting it (mean =2.83); vii) Fraud is systematically identified (mean =2.79); viii) There is any official statistics about the fraudulent financial reporting cases in this organization (mean =2.69); whereas the level of fraudulent financial reporting is fairly satisfactory in terms of ix) Fraud is a major concern for the company (mean =2.39).

This makes the average mean index of the level of fraud detection related to fraudulent financial reporting satisfactory (average mean = 2.82) as indicated in Table 5 A above.

Table 5 B

Level of misappropriation of asset in selected money transfer companies

(n=109)

Measures of Fraud	Mean	Interpretation	Rank
MISAPPROPRIATION OF ASSET			
your organization particularly apply set of fraud management policies to safeguard the organizational and protect errors or irregularities	2.91	Satisfactory	1
The internal auditor has full independence to identify misappropriation of asset	2.90	Satisfactory	2
The internal audit identifies and analysis fraud related to asset misappropriation for determining how the fraud should be managed	2.85	Satisfactory	3
Internal audit programs include tests of physical and accounting controls performed in the following (minimum) areas: (Cash, Consignment items and other non-ledger control accounts, Investment, Loans)	2.85	Satisfactory	3
Actions are taking to identify the possible asset misappropriation frauds	2.83	Satisfactory	4
The company has experienced this kind of fraud	2.81	Satisfactory	5
There are some fraud related to asset in this organization	2.23	Fair Satisfactory	6
Average Mean Index	**2.77**	**Satisfactory**	
Overall Mean Index	**2.80**	**Satisfactory**	

Source: Primary Data, 2012

Results in Table 5 B show that item analysis means indicate that the level of fraud detection related to asset misappropriation is satisfactory in terms of i) organization particularly apply set of fraud management policies to safeguard the organizational and protect errors or irregularities (mean =2.91); ii) The internal auditor has full independence to identify misappropriation of asset (mean =2.90); iii) The internal audit identifies and analysis fraud related to asset misappropriation for determining how the fraud should be managed (mean =2.85); iv) Internal audit programs include tests of physical and accounting controls performed in the following (minimum) areas: (Cash, Consignment items and other non-ledger control accounts, Investment, Loans) (mean =2.85); v) Actions are taking to identify the possible asset misappropriation frauds (mean =2.83); vi) The company has experienced this kind of fraud (mean =2.81); whereas the level of asset misappropriation is fairly satisfactory in terms of only one item ix) There are some fraud related to asset in this organization (mean =2.23).

This makes the average mean index of the level of fraud detection related to asset misappropriation relatively satisfactory (average mean = 2.77) as indicated in Table 5 A above. However, the overall mean index of the level of fraud detection is (mean = 2.80) which is also satisfactory. This result indicates that the level of fraud detection in selected money transfer companies is satisfactory.

Relationship between internal Audit and Fraud detection

The fourth objective of this research was to determine the relationship between internal audit and fraud detection in selected Money Transfer Companies, in order to establish if there is any significant relationship between internal audit and fraud detection of Money Transfer Companies. Pearson's Linear Correlations Coefficient (PLCC) was used to test a null hypothesis that says there is no significance relationship between internal audit and fraud detection in selected money transfer companies in Puntland, Somalia as indicated in Table 6.

Table 6

Relationship between Existent of Internal Audit and Level of Fraud Detection in selected money transfer companies

(Level of Significance = 0.05)

Variables correlated	**Computed r- value**	**Sig.**	**Interpretation of Correlation**	**Decision on H_o**
internal audit Vs. Fraud detection	.615	.0000	Significant relationship	Rejected

Result in Table 6 shows that there is a positive correlation between internal auditing and fraud detection (r= 0.615). Findings indicate that there is a significance correlation between internal audit and fraud detection in selected money transfer companies in Puntland, Somalia. Basing on these results, the stated research hypothesis is rejected, leading to a conclusion that internal audit and fraud detection (sig. = 0.000) are significantly correlated at 0.05 level of significance in selected money transfer companies.

Table 7

Regression analysis for Existent of Internal Audit and Level of Fraud Detection

(Level of significance 0.05)

Variable Regressed	**Adjusted r^2**	**Computed F-Value**	**Beta**	**Sig.**	**Interpretation**	**Decision On H_o**
Internal Audit and Fraud detection	.372	65.024	-	.000	Significant effect	Rejected
Internal Audit Vs Fraudulent	.337	55.785	.585	.000	Significant effect	Rejected
Internal Audit Vs Asset	.232	33.703	.489	.000	Significant effect	Rejected

Results in Table 7 suggest that internal audit positively and significantly affects fraud (F=65.024, sig=0.000). The results indicate that internal audit contributes the variations over 37% towards variation in fraud detection (r^2 =0.372).

The results also indicate that internal audit contribute over 34% towards variation in fraudulent financial reporting and 23% toward variation in asset misappropriation. This implies that internal audit is more important for asset misappropriation compared to fraudulent financial reporting.

Considering coefficient section of Table 7, results indicate that while both the two components of fraud detection when taken together significantly affects by internal audit of money transfer companies, Results indicate that of the two fraud components; fraudulent financial reporting most significantly affects by internal audit (Beta = 0.585); and asset misappropriation component least affects by internal audit (Beta = 0.489).

CHAPTER FIVE

FINDINGS, CONLUSIONS AND RECOMMENDATIONS

Findings

The researcher intended to find out the relation between internal audit and fraud detection. The study was motivated by four objectives as follows; (1) determining the profile of respondents in terms of gender, age, highest education qualification and experience, (2) determining the extent of internal audit, (3) find out the level of fraud detection, (4) determining if there is relationship between internal audit and fraud detection.

Profile of employees in selected money transfer companies in Puntland, Somalia.

The findings suggested that; male (87.2%) dominate female (12.8%) among the employees in money transfer companies in Puntland; education level, secondary level (14.7%), diploma (20.2%), degree holders (50.5%), and master (14.7%), non-of the respondents were hold Ph.D; age, age bracket in between 20 to 39 (56.9%), 40 to 59 (41.3%), and minority of them were above age 60 (1.8%); number of years working, below one year (6.4%), 2 to 3 years (27.5%), 4 to 6 years (38.5%), and 7 and above years (27.5%).

Extent of Internal Audit in selected money transfer companies in Puntland, Somalia

Overall, the extent of the internal audit was satisfactory (mean = 2.81), while that internal audit assess internal control used by the company to detect the fraudulent financial reporting and asset misappropriation (mean = 3.01); rated as the highest item under internal audit indicators, followed by internal auditor assesses management's style, to determine if the style might lead to fraudulent financial reporting (mean = 2.97).

Level of fraud detection in selected money transfer companies in Puntland, Somalia

In general, the level of fraud detection was satisfactory (mean = 2.80). While fraudulent financial reporting is satisfactory (mean = 2.82), and asset misappropriation is also satisfactory and got a mean of 2.77.

Relationship between levels of internal audit and fraud detection

Relationship between extent of internal audit and level of fraud detection in selected money transfer companies in Puntland, Somalia is measured in Pearson's linear correlations coefficient and the results indicate that the extent of internal audit is positively and significantly correlated with fraud detection with (r= .615) and (Sig = .000).

Effect of Internal audit existent on fraud detection

Regression analysis results indicated that internal audit significantly affects fraud detection (F=65.024, sig=0.000), and it explains 37.2% on variation of fraud detection in selected money transfer companies. Results further revealed that internal audit significantly affect both the two components of fraud detection, it affects fraudulent financial reporting (Beta=0.585, sig. = 0.000); in it also significantly affects the asset misappropriation component (Beta=0.489, sig. = 0.000).

Conclusion

The conclusion of this study is based on the purpose of the study in relation to internal audit and fraud detection in selected money transfer companies in Puntland. There is a significant relationship between the level of internal audit and fraud detection in the selected money transfer companies in Puntland Somalia, and also internal audit contributes 37.2% in the variation of the level of fraud detection.

The study also tested hypotheses reached that the extent of internal audit has significance and positive relationship with detecting fraud and concluded to the rejection of the null hypothesis.

The study validated that it is the independent internal auditors who provide an assurance to the board as to the satisfactory performance of management by detecting the likelihood of fraud in the organization as Jensen and Meckling (1976).

Finally, the study significantly contributed to fill literature gap on internal audit and fraud detection in Puntland, Somalia.

Recommendations

Regarding the findings, the following recommendations are provided:

Top management should give input for internal audit planning in money transfer companies in Puntland, Somalia.

Internal audit function of the money transfer companies should be independent in order to detect fraud fairly.

The top management should give more attention for the fraud related asset and that fraud related to financial reporting.

Top management should make the internal audit department more effective so that they can use this more effective internal audit on a regular basis to collect stronger evidence to support fraud detection.

To improve assurance of financial reporting, internal auditing could employ the self-assessment questionnaire technique to staff in order to detect areas of failed controls as a result assure management and the board that systems are effective.

Furthermore, a strong audit committee should be established, training of internal auditors should be done, the capacity of the internal auditors should be increased, even if more are recruited from college graduates, The reports of the internal auditors should be sent to the shareholder board and an audit committee, other than the supervising directors or CEOs, an audit charter should be compiled and approved by an audit committee, the role of internal auditors should be communicated throughout the organization, The internal auditors should adhere to the standards of the generally Accepted Audit Principles (GAAP).

Suggestion for further studies

This study investigated on internal audit and fraud detection in selected money transfer companies in Puntland, Somalia and it found that there is significant relationship between internal audit and fraud detection.

The researcher is recommending for further research to be conducted in areas which are: the relationship between external audit and internal audit; fraud detection and organizational performance.

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APPENDIX I

LETTER OF CERTIFICATION

Dahabshiil

DahabshiilPvt Ltd.

Garowe, Puntland, Somalia-Tell; +252-5-843022/843462

Website: www.dahabshiil.com

Date: 15/07/2012

RE: CONFIRMATION LETTER

I on behalf of the management of DahabshiilPvt Ltdcertify that Ahmed AbshirJama with registration number MBA/33702/111/DF of Kampala International University has conducted data collection research on Internal Audit and fraud Detection in our organization, dated on 15th July, 2012.

HR Manager

Ali Said Mohamoud

SHIRKADA DAHABSHIIL
MAAMULKA
GAROWE OFFICE

APPENDIX IIA

TRANSMITTAL LETTER

KAMPALA INTERNATIONAL UNIVERSITY

Ggaba Road - Kansanga
P.O. Box 20000, Kampala, Uganda
Tel: +256 - 414 - 266813 / +256 - 772 - 322563
Fax: +256 - 414 - 501 974
E-mail: admin@kiu.ac.ug
Website: www.kiu.ac.ug

OFFICE OF THE HEAD OF DEPARTMENT, ECONOMICS AND MANAGEMENT SCIENCES
COLLEGE OF HIGHER DEGREES AND RESEARCH (CHDR)

Date: 04th July, 2012

RE: REQUEST OF AHMED ABSHIR JAMA MBA/33702/111/DF TO CONDUCT RESEARCH IN YOUR ORGANIZATION

The above mentioned is a bonafide student of Kampala International University pursuing Masters of Business Administration.

He is currently conducting a research entitled **" Internal Audit and Fraud Detection in Selected Money Transfer Companies in Puntland, Somalia."**

Your organization has been identified as a valuable source of information pertaining to his research project. The purpose of this letter is to request you to avail him with the pertinent information he may need.

Any information shared with him from your organization shall be treated with utmost confidentiality.

Any assistance rendered to him will be highly appreciated.

Yours truly,

For Mr. Malinga Ramadhan
Head of Department,
Economics and Management Sciences, (CHDR)

NOTED BY:
Dr. Sofia Sol T. Gaite
Principal-CHDR

"Exploring the Heights"

APPENDIX IIB

TRANSMITTAL LETTER FOR THE RESPONDENTS

____

Dear Sir/ Madam,

Greetings!

I am a Master in Business Administration candidate of Kampala International University. Part of the requirements for the award is a thesis. My study is entitled, **INTERNAL AUDIT AND FRAUD DETECTION IN SELECTED MONEY TRANSFER COMPANIES IN GAROWE PUNTLAND SOMALIA**. Within this context, may I request you to participate in this study by answering the questionnaires. Kindly do not leave any option unanswered. Any data you will provide shall be for academic purposes only and no information of such kind shall be disclosed to others.

May I retrieve the questionnaire within five days (5)?

Thank you very much in advance.

Yours faithfully,

Mr. Ahmed Abshir Jama

APPENDIX III

CLEARANCE FROM ETHICS COMMITTEE

Date_______________

Candidate's Data

Name_______________________________________

Reg.# ______________________________________

Course ______________________________________

Title of Study ____

____

Ethical Review Checklist

The study reviewed considered the following:

___ Physical Safety of Human Subjects

___ Psychological Safety

___ Emotional Security

___ Privacy

___ Written Request for Author of Standardized Instrument

___ Coding of Questionnaires/Anonymity/Confidentiality

___ Permission to Conduct the Study

___ Informed Consent

___ Citations/Authors Recognized

Results of Ethical Review

___ Approved

___ Conditional (to provide the Ethics Committee with corrections)

___ Disapproved/ Resubmit Proposal

Ethics Committee (Name and Signature)

Chairperson ______________________________

Members ________________________________

APPENDIX IV

INFORMED CONSENT

I am giving my consent to be part of the research study of Mr. Ahmed Abshir that will focus on internal audit and fraud detection.

I shall be assured of privacy, anonymity and confidentiality and that I will be given the option to refuse participation and right to withdraw my participation anytime.

I have been informed that the research is voluntary and that the results will be given to me if I ask for it.

Initials:______________________________

Date________________________________

APPENDIX V

QUESTIONNAIRES ON INTERNAL AUDIT AND FRAUD DETECTION

INSTRUCTION

This questionnaire is designed with a view to gaining insight into your view as to how internal audit would detect fraud. There are no right and wrong answers and your anonymity is ensured.

PART1: FACE SHEET: DEMOGRAPHIC CHARACTERISTICS OF THE RESPONDENTS

Please place (√) in the space that most accurately reflects you.

1. **Age (Please Tick):**

____ 1). 20 – 39

____ 2). 40 – 59

____ 3). 60 – Above

2. **Gender (Please Tick):**

____ 1). Male

____ 2). Female

3. **Highest Education Level (Please Tick):**

____ 1). Secondary School

____ 2). Diploma

____ 3). Bachelor

____ 4). Master

____ 5). Ph.D.

5. **Number of Years in Working (Please Tick):**

____ 1). Less than/Below one year

____ 2). 1 – 3 years

____ 3). 4 - 6 years

____ 4). 7 years and Above

APPENDIX VI

PART 2: QUESTIONNAIRE TO DETERMINE INTERNAL AUDIT

Direction 1: Please write your rating on the space before each option which corresponds to your best choice in terms of internal audit in your company. Kindly use the rating guide below:

Response Mode	Rating	Description	Legend
Strongly Agree	(4)	You agree with no doubt at all.	SA
Agree	(3)	You agree with some doubt	A
Disagree	(2)	You disagree with some doubt	D
Strongly disagree	(1)	You disagree with no doubt at all	SD

INTERNAL AUDIT

_____1. The internal audit function of the organization is independent

_____2. It is the responsibility of the internal auditor to uncover fraud to report this to the appropriate authorities

_____3. The internal auditor assess internal control used by the company to detect the fraudulent financial reporting and asset misappropriation

_____4. The internal auditor assesses management's style, to determine if the style might lead to fraudulent financial reporting.

_____5. The management of the company implements the findings of internal audit

_____6. The internal auditor checks conflict of interest in order to detect fraud

_____7. The internal audit test bank account reconciliation for accuracy

_____8. Has active participation in implementing fraud detection

_____9. Provides independent assurance on fraud detection

_____10. Assist and advice, a new separate fraud detection function

_____11.The internal auditor checks customer accounts for proper disclosure

_____12.The internal auditor checks the monitoring and resolution of customer compliant

_____13.The internal auditor review all returned bank statements for an appropriate period subsequent to the examination date

_____14. The work of internal audit and fraud detection are interrelated

_____15.There is differences between internal audit and fraud detection

_____16. People within the organization perceive Internal Auditor as they Partner

_____17. Top management gives input for internal audit planning

APPENDIX VII

PART 3: QUESTIONNAIRE TO DETERMINE FRUAD DETECTION

Direction: Please write your preferred option on the space provided before each item. Kindly use the rating guide below:

Response Mode	Rating	Description	Legend
Strongly Agree	(4)	You agree with no doubt at all.	SA
Agree	(3)	You agree with some doubt	A
Disagree	(2)	You disagree with some doubt	D
Strongly disagree	(1)	You disagree with no doubt at all	SD

FRAUDULENT FINANCIAL REPORTING

____18. Fraud is a major concern for the company

_____19. Fraud is systematically identified

_____20. Actions are taken to address risk to the achievement of financial reporting objectives.

_____21. The organization has a fraud related to financial reporting.

_____22. The organization practically apply a set of fraud detected polices to maintain sound financial reporting

_____23. The potential of material misstatement is explicitly considered in detect fraud.

_____24. Frauds relevant to organization financial reporting have been managed.

_____25. When fraudulent activity is present or suspected, specialized internal audit activities may be performed to assist management in detecting it.

_____26.there is any official statistics about the fraudulent financial report cases in this organization

MISAPPROPRIATION OF ASSET

____27. There are some frauds related to asset in this organization

____28. Actions are taken to identify the possible asset misappropriation frauds.

____29. The internal audit identifies and analysis fraud related to asset misappropriation for determining how the fraud should be managed.

____30. The auditor has full independence to identify misappropriation of asset.

____31. The company has experienced this kind of fraud.

____32. Your organization practically applies set of fraud management policies to safeguard the organizational assets and protect errors or irregularities.

____33. Internal audit programs include tests of physical and accounting controls performed in the following (minimum) areas:

- Cash
- Consigned items and other non-ledger control accounts
- Investments
- Loans

APPENDIX VIII

RESEARCHER'S CURRICULUM VITAE

Ahmed Abshir Jama

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EDUCATION

- Kampla International University- Master Candidate
- Puntland State University (PSU) - Bachelor of Business Administration 2005-2009
- Garowe Teachers' Education College(GTEC) at Garowe- Diploma 2005-2008
- AL Waxa Secondary School at Garowe City-high school certificate 2001-2005
- AL Waxa Primary and Intermediate School at Garowe City 1995-2001
- Ibnu Mascuud Kuran School at Garowe City 1990-2000

WORK EXPERIENCE

ACCOUNTING CONSULTANT, Puntland Ministry of Finance (MoF) Bosaso, under Somali Institutional Development Project SIDP/UNDP 2009-2010

OWNER AND MANAGER OF SMALL BUSINESS, in Garowe City 2008-2009

ACCOUNTANT, for Waamo Bar and Restaurant in Garowe City 2007-2008