Internal control system for small business to reduce risk of fraud

Case study: Company D, Vietnam

Tran Loan

Degree Thesis

Degree Programme

15th April 2015

DEGREE THESIS	
Arcada	
Degree Programme:	INTERNATIONAL BUSINESS – BBA11
Identification number:	4888
Author:	TRAN LOAN
Title	Internal control for small businesses to reduce risk of frauds Case study: Company D, Vietnam
Supervisor (Arcada):	Thomas Finne
Commissioned by:	

Abstract:

Regardless of sizes or sectors, all organizations could be vulnerable by frauds, especially small business entities were victimized in the greatest percentage of cases, and also suffered excessively huge losses because of fraud.

This study aims to describe frauds and how internal control system could help small businesses prevent frauds and thereby reduce risk of frauds. The case study of company D was employed in this research in order to provide practical matters in relation to fraud and internal control system at this company. How a good internal control system should be applied to a small business will be indicated through the case of company D.

The literature chapter is collected from various resources such as books, articles and online sources. The empirical data of the case study is gathered by two research methods: questionnaire which sent to employees working at the company and interview which conducted with three managers of the company. After obtaining adequate theoretical framework and practical data, an in-depth and comprehensive analysis is carried out based on those data. The results reveal that the company D is to some extent having a rather good internal control system, yet needs more improvements, particularly attentions from the company's boards of directors to different departments. Several possible solutions are suggested based on the author's understanding of practical current states at company D.

It is believed that this thesis is providing helpful information for the case company as well as others in terms of internal control system to reduce risk of frauds.

Keywords:	Internal control system, control environment, risk assessment, control activities, information and communication, monitoring, fraud, segregation of duties, review and oversight, authorization, company D.
Number of pages:	96
Language:	English
Date of acceptance	

CONTENTS

List of Figures

List of Tables

FOREWORD

First and foremost, I would like to express my appreciation to my thesis supervisor, Mr. Thomas Finne for his enthusiastic supports and great guidance during my research paper. He has been always working in a professional way with very quick replies and offers timely advices to his students.

Moreover, I would like to send my special thankfulness to managers of the company D as well as all employees working there for helping me obtain a plenty of valuable data. I express my gratitude to Ms. Hong Le – accounting manager and Mr. Pierre – purchase manager for their supports and great answers. My special appreciation directs to Ms. Ashley Le – sales manager at D, who gives me a chance with her permission to conduct research at her company and also support me a lots with her great attitude and interest to the research.

Last but not least, I would like to express my gratefulness to my family with their endless love and encouragement. Also, my big thanks send to all of my best friends who always love and care for me.

Helsinki, 30th April, 2015

Tran Loan

1 INTRODUCTION

Over the past decades, there has been an issue of inaccurate and unreliable financial reporting which is considered as fraud in business world. The two most well-known scandals are Enron and WorldCom. From the lesson of those scandals, organizations nowadays have invested increasingly their internal control systems in purpose of enhancing a well-improved system which is able to reduce as much as possible the risk of frauds. A sound internal control system helps organizations warrant that operating objectives, financial objectives and compliance objectives are met and combined. Hence, internal control system can be seen as the fundamental to supporting the achievement of an organization's objectives and creating, enhancing, and protecting stakeholder value. Internal control also plays an important in the survival of business which can be considered as an organization's governance system and ability to manage risk. More specifically, internal controls are operational measures which designed to monitor the firm's assets, prevent fraud, minimize errors, and authenticate the accuracy and reliability of accounting data.

Internal controls not only are used by the managers but also by accountants and auditors to test the effectiveness of the firm's ongoing compliance with established financial and managerial practices implemented by the firm. Effective internal control can help organizations improve their performance by enabling them to take on additional opportunities and challenges in a more controlled way. As a result, there needs to be a better understanding of how a sound internal control system helps the company enhance their management and simultaneously minimize risk of frauds.

In order to obtain the in depth about how internal control system supports the enterprise in terms of reducing risk of fraud in real life, a case study of a French IT which referred to be addressed as company D in this paper are employed to investigate. With the real life case for the study, the author hope this research will be helpful to the company D as a comprehensive reference for its internal control enhancement.

1.1 Research question

This study will critically examine the two following research questions as the main destination of this paper:

- *How does internal control perform at company D in relation to fraud prevention?*
- *How to improve internal control system for company D to reduce risks of fraud?*

1.2 Aim of study

The objective of this study is to gain greater understanding about the current practices of internal control system at company D and additionally, examine the effectiveness of the system in correspondence with anti-fraud activities. In order to do that, the study aim is firstly to answer two research questions mentioned above. Secondly, the study outcomes should be practical related with theories that author gathered in the study. It means that those results are theoretical and the empirical perspectives which can create the benefits to people concerning about the study, be useful to management level, to boards of directors and perhaps to any stakeholders of the company D.

1.3 Limitations

There are limitations in this research. It is believed that internal controls as well as how it helps entities prevent fraud are huge perspectives. Therefore, not all internal control tools and fraud-related aspects of a company will be analyzed in this study. Besides, internal control system for non-profit organization is also outside the extent of this study.

2 CASE COMPANY – COMPANY D

2.1 Background

The company D is a French Information Technology business enterprise, which was established in 2003 in Ho Chi Minh City, Vietnam. The company is known as one of the very first information technology (IT) company in terms of IT outsourcing at that point of time. After years of operation, nowadays, D expands its business with another office in Hong Kong. Company D corporates with a plenty of entities at local and global reaches. Several outstandingly successful global braches such as Nestle, Nokia, SAP, Levi's and L'Oréal are currently cooperating with company D in regard to IT services. (Ashley Le 2015)

According to Ashley – sales and project manager of company D, in 2014 the company revenue was reached over $1.4 million which is the highest range from the past ten years. (See more at table 1, p.10)

- **IT outsourcing service**

Clearly, as an IT agency, the company has been mainly focusing on IT service to all customers in needed. Company D has contributed a various range of software developments for different project ranges such as short-term, long-term projects, and even fully-fledged project lines. The more complex technical factors and mobile platforms are required from customers, the longer in time and the more work need for that project. Yet, regardless of types of product require, the company always gives the same concentration toward high quality, time saving, cost efficiency and excellence. (Ashley 2015)

There are 3 major kinds of services that company D mostly focuses on:

– Third party applicative maintenance: brings to client from the early-stage project idea to the last-stage completed products. Moreover, the company also support clients with plans for architecture, detailed design and operation.
– Software execution: provide advices in correspondence with application development and maintenance needs to client as fullest.

– Products and service for non-IT clients.

- **People at company D**

About human resource, company D is the ideal working place for more than 50 employees working with the aim of delivering excellence IT services to clients, not only in Vietnam but also over Euro region. Most of employees were recruited at Vietnam, and so far others come from different countries with different cultures such as France, China, India, etc. Generally speaking, company D is an international company offering to its employees a friendly and motivated environment in place to obtain the best outcomes.

2.2 Financial status

Table 1: Key figures about D's financial status in 2014 comparing to 2013 (Adapted from financial statement of D 2014, Ms. Hong Le)

KEY FIGURES

	2014		2013	
Net sales		1,423,956		1,156,480
IT service	1,307,816		995,154	
Product	116,140		161,326	
Expenses		-1,111,380		-898,918
Profit before tax		312,576		257,562
Balance sheet total		1,257,596		1,052,065
Interesting-bearing liability		443,666		467,010
Cash and cash equivalents		284,670		152,950
Return on equity, % (ROE)		6.15		4.99

2.3 Accounting system

According to Ms. Hong Le – accounting manager at company D, since it is a SME (small and medium-sized entity) the board of directors referred to use an accounting software that has usages and functions dedicated to small business only. In Vietnam, FAST accounting software is a well-known and highly-evaluated program which is greatly suitable to small business features. Recognized the appropriateness of FAST accounting software, the board of directors decided to take it in use.

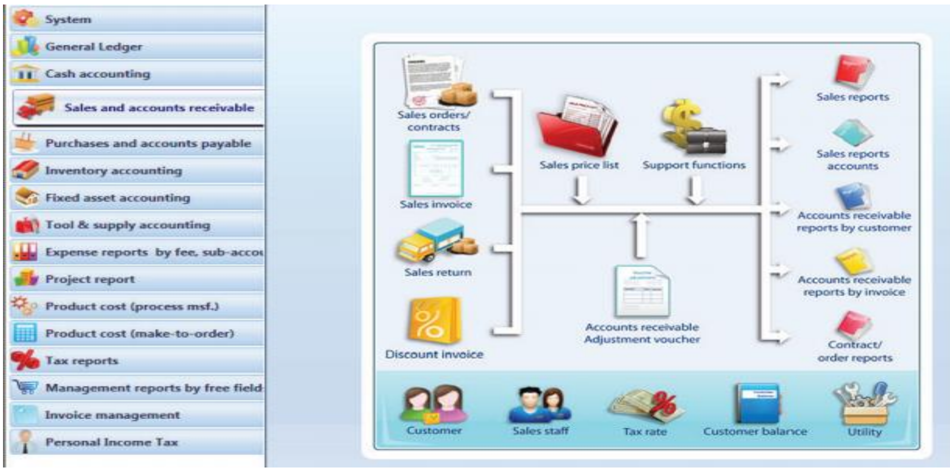


Figure 1: Function menu of FAST accounting software being used at company D

There are sixteen modules comprising at this accounting software, some outstanding modules are cash accounting; sales and accounts receivable; purchase and accounts payable; and expense reports, etc. For a small business, a sound internal control system with purpose of reduce risk of fraud would be strongly associated with these modules. Further chapter will give more explanation relating to this.

3 FRAUD

According to Rodney and Mario (2014, p.1), no entity is immune from fraud or in the other work, entities cannot avoid totally from fraud. It effects all types of organizations regardless of sector, size, public or private, country, etc.

From a global study conducted by Association of Certified Fraud Examiner (ACFE) in 2014, the result was indicated that a business entity, every year, loses approximately 5% of its revenue to fraud. Additionally, the study also showed that six of ten companies in the survey was impacted by fraud in recent years. (Association of Certified Fraud Examiner 2014, p.4)

3.1 Fraud overview

Fraud is a broad legal concept and there are various definitions of fraud. Those definitions, to some extent, had covered common areas about fraud but each of them is slightly different. Fraud definition was mentioned in the study of ACFE in correspondence with occupational term which is defined as "*the uses of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources and assets*". In other words, occupational fraud means a person defrauds his/her employing association; therefore fraud is not an unintentionally mistake but with purposes, for instance, an incorrect accounting estimate, the solicitation of a cost to an improper account or even withdraw cash into pocket. (Report to the nations on occupational fraud and abuse, ACFE, 2014 p.6)

- **Cost of fraud**

Definitely, all kinds of fraud are threats to organizations regarding to damaging not only financial losses but also untangle assets such as reputational status and trust of stakeholders. Therefore, all entities had better to take a considerable attention to fraud. (Rodney and Mario, 2014, p.7)

ACFE pointed out that "the nature of fraud means that much of its cost is hidden" (2014, p.8). The reason for the statement is that in most of fraud scandals, the concealment is the intrinsic component and even some fraud cannot be covered, measured and reported. Furthermore, most frauds create many indirect costs which as mentioned before such as reputational damage, trust, and cost in correspondence with investigation in order to find out fraud into light.

ACFE stated in its report about cost of fraud with an image of financial iceberg. It means that some fraud direct costs by some means are normally observable and visible, but meanwhile there are also a plenty of indirect costs related as a huge mass of hidden harm which people cannot see like a large iceberg staying deeply in the water. (Report to the nations on occupational fraud and abuse, 2014, p.8)

- **Drivers of fraud – The fraud triangles**

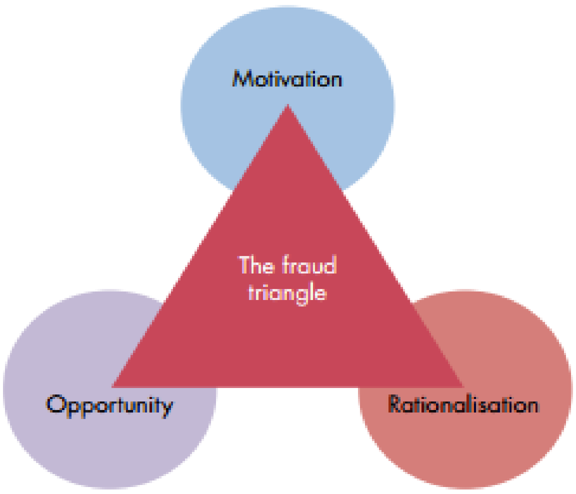


Figure 2: The fraud triangles (Source: Global profiles of a fraudster, KPMG International, 2013, p.7)

As seen in the model above, three components which represent as three drivers or factors that push a person in order to commit a typical fraud are opportunity, motivation and rationale. It is believed that people are going to carrying out a fraud once that three factors come about instantaneously (KPMG, 2013, p.7)

Opportunity – Basically, opportunity is the weakness in the internal control system that create condition to allow fraud to take place (Rodney and Mario, 2014, p.9). From the result of KPMG team's survey, they found that the plurality of fraud mostly come from employees working at victim organizations for more than five years. This somehow means that employees committing frauds, or called fraudster, do not join entities with purpose of conducting frauds. The changing of personal circumstances or pressure in work or even a weak internal control system in the organization, in fact, becomes the opportunity and perfect conditions for fraudsters.

Figure 3: Tenure of fraud commitment in relation to working years – global research (%) (Source: Profile of a fraudster, Association of Certified Fraud Examiner 2014)

Motivation – Motivation in this triangle model can be understood as an event or situation that leads a person to think about possibility of committing fraud. Relatively speaking, the crushing reason or the main motive for committing a fraud is financial gain. This statement was found from KPMG survey about fraudsters as well. Statistically, two third of fraudsters in the survey answered that their main motive for committing a fraud is relating to greed and financial gain or financial difficulty. (KPMG, 2013, p.7)

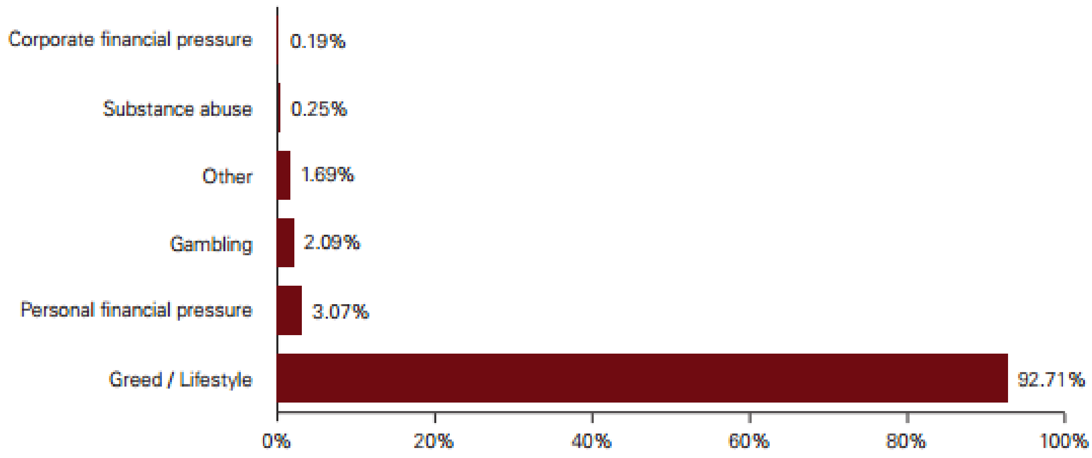


Figure 4: Major fraud motivation – global research (%) (Source: KPMG report, 2013, p.7)

Rationale – Behind a fraud, there is commonly a rationale which is provided for fraudster's deeds. Rationalization seems to be a psychological factor belonging to human being or it can be seen as emotional motivators such as anger, fear or even sense of being under-remunerated (KPMG, 2013, 8.). This overriding factor arise in fraudster's mindset when committing a fraud. In detail, at that time, this person assumes him or herself that it is acceptable to acting so in his/her country. One of the significant emotion of rationalization was concluded in the survey is the sense of superiority, which is accounted for 36 percent of fraud scandals. Fraudsters with superiority sense are frequently executive directors of companies.

3.2 Types of fraud

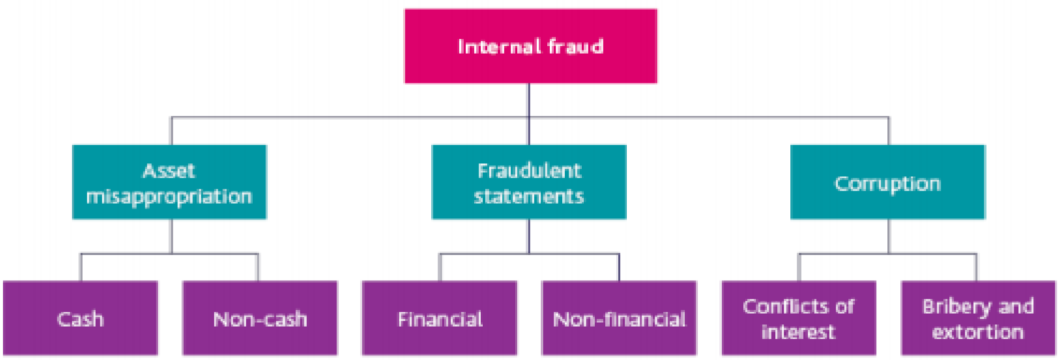


Figure 5: Types of internal fraud (Source: CGMA, Fraud Risk Management, p.4)

In this paper, because of its purpose involving with business content, author only focus on fraud that against business, most importantly those internal frauds occur in business entities. According to Chartered Global Management Accountants (CGMA), frauds can be divided into 3 main categories, they are, namely: asset misappropriation, financial statement fraud and corruption. From the three primary types, there are several following subcategories classified under each main one as shown in the internal fraud type graph above.

- **Asset misappropriation**

Asset misappropriation is concerned as a theft or misuse of assets, carried out by employees of an organization. Statistic data from ACFE regarding to this type of fraud shows that 91% of internal fraud commitments related to asset misappropriation section. Asset misappropriation instances can comprise such as stealing cash, plant, inventory; creating fault invoices, accounts and payroll; or even overstating of expenses in reimbursement. Some of asset misappropriation can comprises of:

- Cash schemes, more specifically, includes theft of cash receipts (skimming in sales or receivables; and cash larceny from register or from the deposit) and fraudulent disbursements (check tampering, billing schemes, or payroll schemes).
- Non-cash asset schemes insists of misuse of inventory/fixed assets; and theft of inventory/fixed assets.

- **Fraudulent statement**

This term refers as intentional frauds which usually done by organization's managers with correspondence to making false entries in bookkeeping and financial statements. This type of fraud is to aim to attain improper benefit from the misleading statement reports. Some examples include falsifying accounting transactions for instance sales order or inventory tags; or more seriously, modifying financial report with the purpose of making it perform better than it truly is.

- **Corruption**

According to Tommie and Aaron (Tommie & Aaron 2010), corruption is existing in all industries, not only in politics or government. It is an act which committed by inside employees of victim entities working with someone from the outside. Moreover, most common bribery and corruption is related to cash and does not involve any paper trail after that. Without paper trail, corruption investigation process will be going to meet a lot of difficulties in order to track and find out the final result. Also, from Tommie and Aaron, the bribery and corruption activities with the involvement between in and out related-party usually comprise of the use of bribes, kickbacks, use of information with improper purposes and last but not least, the conflicts of interest.

- **Fraud schemes statistics**

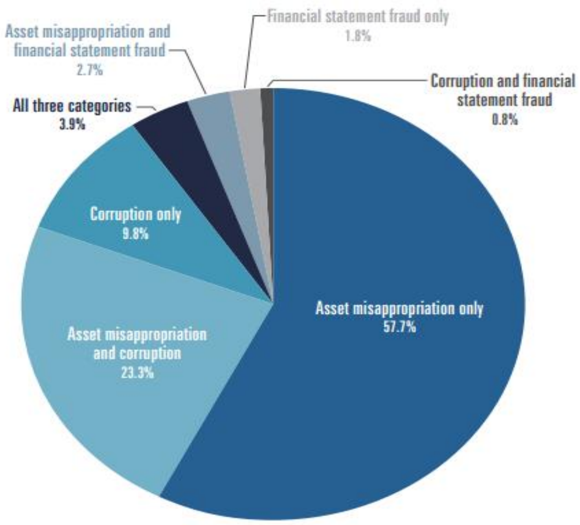


Figure 6: Overlap of fraud schemes – global research (%) (ACFE, Report to the nations on occupational fraud and abuse 2014, p.15)

Regarding to fraud schemes, asset misappropriation is concerned as the most frequent and popular scheme with its account of nearly 58% of all fraud cases in 2014. Definitely, the number of cases relating to this scheme is bigger when there are other cases having its presence, for example, the cases of overlap of asset misappropriation and corruption as well as the mixture of asset appropriation and financial statement fraud are calculated, respectively, at 23.3%, and 2.7%.

Following asset misappropriation, there are corruption and financial statement fraud in the range of 9.8% and 1.8%

3.3 Fraud statistics relating to small businesses – A big concern about fraud

As said by ACFE in the report published in 2014, small business which is considered as business entities with less than 100 employees, were the biggest victim in terms of percent in cases.

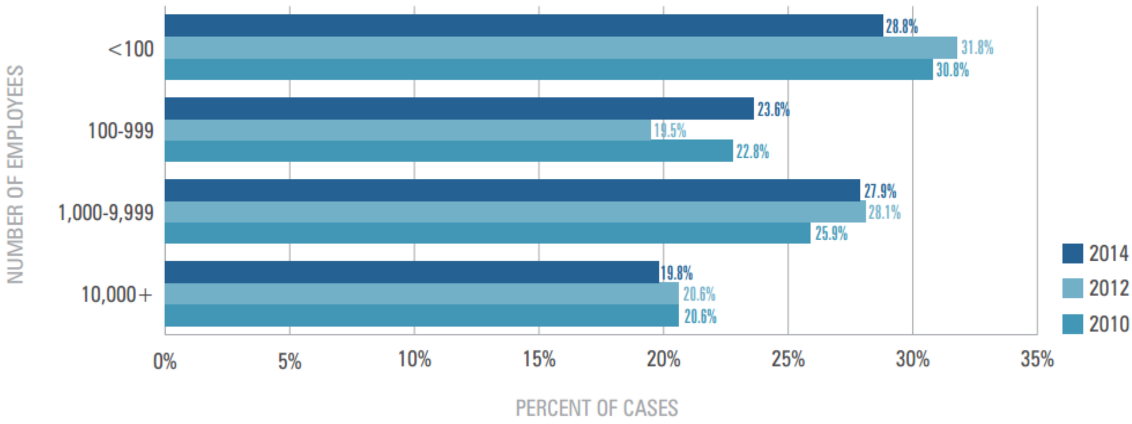


Figure 7: Size of victim organization in frequency – global cases research. (%) (ACFE, Report to the nations on occupational fraud and abuse 2014, p.25)

Furthermore, in coherence with median loss, small businesses also belongs to the greatest loss groups, which goes as the second, following only the large entities (those are having more than 10,000 employees). The median loss for small businesses and large businesses are $154,000 and $160,000, respectively. From here, it is easy to understand that, large entities (more than 10,000 staff) with median loss is plainly higher that small businesses; however, the loss of $154,000 for a small business with fewer than 100 employees every year is much more serious and heavily damaged comparing to the loss of $160,000 annually for a large business with comprising of over 10,000 employees.

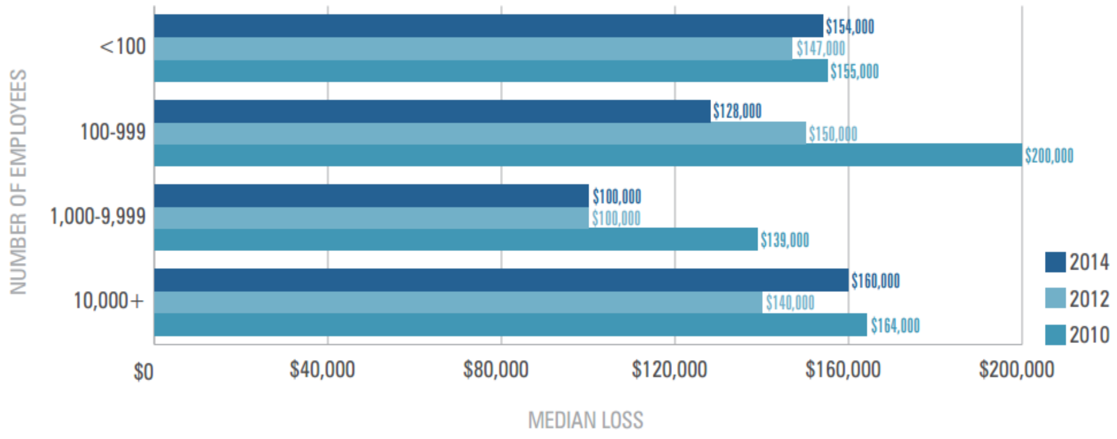


Figure 8: Size of victim organization in median loss – global research (ACFE, Report to the nations on occupational fraud and abuse 2014, p.25)

Moreover, the following figure will clearly indicate that small businesses have to cope with a plenty of different types of fraud in cases than the rest of business entity sizes.

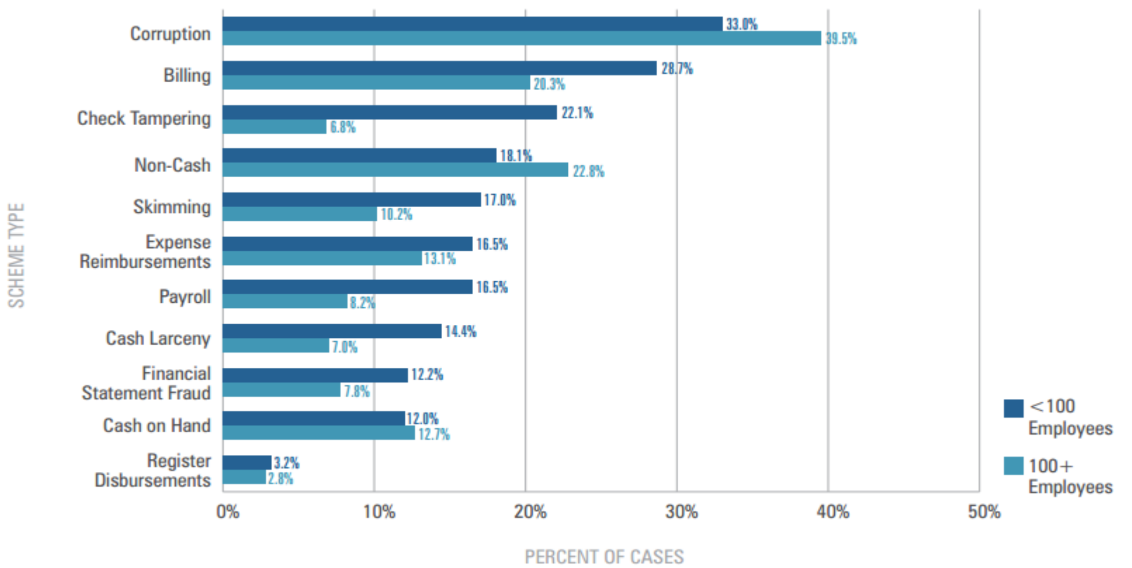


Figure 9: Scheme types by size of victim organization – Global research (ACFE, Report to the nations on occupational fraud and abuse 2014, p.26)

3.4 Sarbanes-Oxley

3.4.1 Fraudulent accounting scandals

3.4.1.1 Enron scandal

Enron Corporation originally named Northern Natural Gas, founded in 1931 in Omaha Nebraka. In 1985 the company acquired Houston Natural Gas Corporation and changed its name to Enron. (Krishna & Paul 2003)

Figure 10: Enron's logo

Initially Enron's activities focused mostly on the field of transmission and distribution of electricity, and gas across the United States; construction and operation of power plants and the system path of natural gas. Enron's revenues at this time largely depended on these kind of manufacturing activities. Enron has about 22,000 employees and was one of the leading energy group in industry of natural gas and electricity supply. Revenues of Enron in 2000 reached $111 billion. Enron was truly an energy company with dizziness in its increase. From 1990 to 2000, Enron's stock surged dramatically by 311 percent. At this time, Enron's stock price peaked at $ 90 in August 2000. Consequently, Enron was rated as one of the seven largest US corporations in terms of the value of shares on the stock market (Krishna & Paul 2003). A year later, however, in 2001 Enron's financial situation changed. In October 2001 Enron announced that it had $628 million in loss for the third quarter as well as the shareholders' equity was decreased in the range of $1.2 billion at the end of 2000. In November 2001, for the first time in the history of Enron, the company's stock price plummeted to below $1 for a share. (Krishna & Paul 2003)

Thanks to the inexact information about managerial quality and financial reports so far, Enron's image was marketed effectively by one of the leading auditing firm Arthur Andersen and also by the Wall Street analysts. Consequently, it was easily understandable that a plenty of people were going to buy shares of Enron and made the record as regards Enron's number of share. Branch of Arthur Andersen in Houston gave the false audit reports in order to benefit Enron's image in paper; furthermore, Arthur Andersen engaged in the work of finding new partners for Enron. For this job, Arthur Andersen will receive $ 1 million per week remuneration. Certainly, this large amount of this remuneration was blinded on the audit staff and controlled them easily to ignore all auditing rules in order to enhance the Enron's ability in the public eyes.

With a rapid growth strategy, Enron's board of directors had been actively acquired other companies and assets by a large capital from banks as well as by issuing options to purchase shares of Enron. At this time, the board of Enron was no longer operating companies in the field of manufacturing and trading power, they just had jumped into the field of financial services in the energy sector which was the most highly risky aspects in business world. However, Enron's board of directors did not follow and comply the principles of governance that the company had set before. Board of directors and the senior managers put much pressure on the lower level of managers in regard to change the reality of financial reports as well as used money to bribe auditors from Arthur Andersen in order to keep silence about their debts are considers as the main causes leading to the collapse of Enron, one of the top 10 largest corporations in America in the early 21st century. (Krishna & Paul 2003)

- **Misuse of Special Purpose Entity (SPE) associated to debt**

Enron established many SPE in the purpose of funding simultaneously managing financial risks in relation to specific assets. SPEs are entity founded by a sponsor, yet is funded by other independent investors and debt financing. For instance, when Enron developed new oil pipeline, the company could create a SPE. This SPE unit sponsor would become the owner of that pipe and use it to mortgage loans from other debt financer or independent investors for its construction. Enron had the right in use of this pipe and obtained the revenue from the oil pipe to pay to creditors. By this way, Enron’s balance sheet would not show the Enron assets (pipeline) from SPEs and the associated debt liability. At the time of collapse, Enron had 900 SPEs. Enron used these SPEs to manipulate financial reports and conceal hidden information that should be published to investors. In more details, Enron took advantages of the SPEs' represents as legal statuses to borrow and get debt financing from banks or other investors. Experts analyzed that there were two reasons to explain why banks, at that time, were willing to give a hand as regards capital support to Enron in order to establish a great volume of SPEs; firstly, banks and creditors believed that SPE's business activities were under assurance of Enron; secondly, they also had confidence in Enron's remarkable operating ability as well as its reputation. The more banks and creditors invested in Enron's SPEs with millions of dollars, the greater Enron had had in debt which was unfortunately excess over its ability to pay back. (Krishna & Paul 2003)

- **Inflating revenues and profits and hiding losses**

The fact shows that prices of products in the energy sector such as oil, coal, etc. tend to fluctuate sharply, while customers always wish the price a stability. As a large supplier, Enron signed a great deal of future fixed contracts with customers and also received fees from those contracts. Income from these kinds of contracts were added into the current revenue of the company and made Enron's income statement more attractive than it was, while the products had still not delivered and consequently Enron will suffer a large volume of risks in the future. With regard to SPEs, Enron sold assets to SPEs which were own by Enron with an unreal-highly prices or inflated prices to create artificial profits. Enron also purchased or resold assets with SPEs to increase sales in revenue or reduce the fluctuation of profits. It means that there was no any new production, no new income was created, there was only the move of assets with high prices from Enron to SPEs or vice versa.

According to economic experts, a healthy operating company shall disclose its transparent financial statement with its counterparts and vice versa. However, either many Enron's partners or Enron did not comply this auditing principles into their business and definitely this make them powerless to control financial situation. A company with revenues of over $ 100 billion but incredibly up to $ 10 billion in profit was such an unreal story. This was probably the basis of suspicion for investigating this conceal of Enron scandal to go to the light. Total debt was $ 1.2 billion hided by Enron had caused panic in the stock market for people when the debt was revealed to the public. Regarding to Enron's loss conceal, after Enron's investigation, result come out that Enron, in the first time, reported with losses after quarter III of 2001, but actually incurred losses occurred from previous years. (Krishna & Paul 2003)

Enron scandal, at the time of its bankruptcy, was considered as the most significant corporation collapse that ever hit financial world. There was no excuse for Enron's director as well as its auditors – Arthur Andersen. From this scandal, not only in business but also state government, fraud in accounting as well as corporate fraud are in attention and the worth lesson from the scandal will always be in respect to prevent other similar frauds.

3.4.1.2 WorldCom scandal

After one year of Enron's collapse, public was in panic gain for WorldCom's scandal. Its bankruptcy filling in 2002 was such a biggest filling ever for debt and financial accounting fraud which assets of nearly $11 billion, more than double the record of Enron in 2001.This scandal effected badly on the belief of public when it became the worst corporate crime in business until now which involvement of WorldCom's boards of directors in correspondence to their criminal punishments as their consequences after the scandal going to light.

Before scandal was found out, WorldCom was still referred as the second largest long-distance telecommunications company in the US which went to public in 1989. WorldCom speedily blasted in expansion through "mega-deals" buyouts with purchasing over 60 smaller companies in the second half of 90's, reaching a market value of $180 billion, employing 80,000 workers. WorldCom was operating effectively to attain remarkable statistics which was handled 50% of the US internet traffic as well as 50% of e-mails globally. Bernie Ebbers was the founder and also CEO of WorldCom at that time. (Bob L. & Mark J. 2002).

Figure 11: WorldCom's logo

The outburst of dotcom industry was a bad sign for the climb down of telecommunication industry 1998, and definitely WorldCom was not the exception. Furthermore, people started suspecting the concealment behind the development of WorldCom. According to economic experts, WorldCom not only took advantages of using unethical and questionable accounting practices to mask its decline in financial status, but also recorded improperly an expenditure of $3.85 billion into expenditure account. This large volume of capital was used to speed up and inflate WorldCom's cash flow and profit within 4 quarters of 2001 as well as the first quarter in 2002. Meaning that instead of losing of $1.2 billion in 5 quarters, the corporation told the lie to public with profit of $1.6 billion in the whole year 2001 and $172 million of income in the first quarter of 2002. More specifically with statistics:

- In 2001, the EBITDA of WorldCom (Earnings before interest, taxes, depreciation and amortization) was announced with $10.5 billion. In fact, however, this figure was calculated by investigators that it should be only at $6.3 billion. Similarly, first quarter WorldCom's EBITDA in first quarter of 2002 was announced with volume of $2.1 billion but when the company went to its bankruptcy, this figure was discovered just approximately of $1.4 billion.
- WorldCom was in the debt and liability of $2.65 billion, and even before going bankruptcy, it was intending negotiating to borrow $ 5 billion from banks and other big investors. Banks which become victims of WorldCom namely, were Bank of America, J.P. Morgan Chase, Citigroup, FleetBoston Financial, Mellon Financial, Bank One, Wells Fargo, etc.
- Value of shares of WorldCom had been at peak at some point closely to $63.5 per share. However, in March 2002, the US investigating authorities had been investigating the fraud at WorldCom and result come out with a detect fraud in excess of $ 3.8 billion. Consequently, share price of WorldCom immediately dropped to $6.74 per share and continued to decline until June 2002.

After the financial fraud activities of WorldCom's board of directors were recognized by audit department in June 2002, on 19/07/2002 WorldCom – the long distance telecommunication corporation, also the second largest after the United States AT & T, had to go to the bankruptcy filing for its fraudulent accounting profits which was worth close to $11 billion. (Bob L. & Mark J. 2002)

With respect to experts' analysis to WorldCom scandal case, there were main two reasons to explain for its collapse:

- **Commit fraudulent financial statement because of its growth strategy**

Experts said that the driving factor behind committing this fraud originally come from the business strategy of WorldCom's CEO. Bernie Ebbers' strategy in terms of expansion was the pursuit of large M&As (Merger and Acquisition). In order to complete this growth strategy, Ebbers attempted to show off his corporation's continuous increasingly revenue and profit as the best as it could. WorldCom rose its existing fake indicators in accordance to accounting and did not mentioned the capital data over time which was supposed to publicize. In essence, WorldCom exchanged a series of numbers from a column to another column in the financial statements. It was certainly a mistake of WorldCom's leaders. AS mentioned above, in 2001 and first quarter of 2002, WorldCom was added $3.8 billion in their capital investments account, yet this amount actually was used in its daily expenses. It is undoubted that those two terms were clearly different in use because capital investments are treated differently for purposes of cost accounting. Capital investment term is the money used to purchase long-term assets and therefore, this cost would be spread out in serious of years. (Bob L. & Mark J. 2002)

- **Managerial issues after M&A**

According to Mobberg & Roman (2003), after a merger and acquisition, there are a plenty of substantial managerial challenges that board of directors need to solve. Most importantly, corporation's management scopes with a challenge of how to smoothly integrate the smaller acquired assets and other resources into the unification of mother company. It is believed that this integrated process is always a time-consuming practice; also the process requires a very well-organized as well as wisely-thoughtful plan by managers. In the case of WorldCom's failure, its board of directors was only giving their focus on acquisitions which question "how and how much" to take over other smaller entities, without demonstrating any considerations to follow-up phases. As the result, WorldCom was in a conflict in terms of variety of computer systems, overlapping of human resources, improper of billing systems, etc. Those managerial issues of integrating was considered as one of reason leading to WorldCom's collapse.

3.4.2 Sarbanes-Oxley Act of 2002 (SOX)

According to Horngen (2012, p.342), after the number of shocking collapses of many American corporations such as Enron, WorldCom, etc. with the lost billions of dollars, subsequently as a response to those financial scandals, the U.S. Congress enacted a new law to prevent financial fraud and protect investors better, which so called Sarbanes-Oxley Act (as more often known as SOX).

Congress was passed the Act on 30th July 2002. This legislation was designed and sponsored by Paul Sarbanes and Michael Oxley which is one of the most important laws changing and effecting all listed U.S. companies since it was born. Sarbanes-Oxley Act of 2002 was 66 pages long which contains the most important supplements in the U.S. Securities Act. The most outstanding aim of this law is to restore public confidence and trust in the companies' financial reporting by fixing and supplementing the existing regulations to ensure greater transparency of financial reports, as well as to bring transparency to the stock market. (Horngen 2012)

There are two main highlighted provisions founded from Sarbanes-Oxley Act of 2002:

- **Section 302**: A mandate that highlights on senior management's responsibilities in terms of accuracy of financial statement when reporting to public.
- **Sections 404**: This section is associated to internal control within an entity. It said that there is a requirement for both management and auditors to design internal controls and an adequate reporting methods as regards internal control system. In the other words, the law adds specified constraints associated to personal responsibility of the CEO and CFO for the reliability of financial reporting, especially the control of accounting.

Moreover, the important advancements of Sarbanes-Oxley can be seen through following points:

- In section of corporate disclosure and governance, periodical financial statements are required certification by CEO or CFO within those financial reports. This section ensures the formality and the integrity of their company's reports. If there are errors, they can go to prison. (Orrick 2002)
- In section in accordance to enhancing corporate disclosure and oversight, Sarbanes-Oxley Act mentioned that the company must establish accounting oversight board performs the function of monitoring the accounting activities within itself, while also closely monitoring the activities of its audit firm. (Orrick 2002)
- In addition, the section of auditor independence considered that one auditor is not able to be responsible for all auditing process for one corporation in order to avoid the benefit concentration toward one auditing firm which can lead to fraud commitment. Also, the Act requires the rotation of audit partner should be changed every year.
- Board of directors of the company may not choose or decide to terminate the contract with its audit firm. That decision belongs to the audit committee of the company.
- Annually, companies must conduct and publicize their internal control report. This report have to contain information on the financial situation of the company with certification by auditing firms. (Orrick 2002)
- In the section 802 which called sanctions for criminal and civil wrongdoing, the Act states clearly that any charges related to change, destroy records and documents or influence legal investigation can be sentenced up to 20 years. (Orrick 2002)

To sum up the Sarbanes-Oxley Act of 2002, the below table will demonstrate it to some extent:

Table 2. Sarbanes-Oxley Act Key Provision Summary (Tommie & Aaron 2010)

The following are the major sections of the SOx legislation of interest to risk managers and internal auditors. The titles of these sections show the broad areas covered by the SOx legislation. More detailed descriptions of some sections—including the important Section 404—are in the text of this chapter.

Section	Subject	Rule or Requirement
101	Establishment of the PCAOB	Overall rules for the establishment of PCAOB including membership requirements.
104	Accounting Firm Inspections	Schedule for registered firm inspections.
108	Auditing Standards	The PCAOB will accept current auditing standards but will issue new standards.
201	Out of Scope Practices	Outlines prohibited practices such as internal audit outsourcing, bookkeeping, and financial systems design.
203	Audit Partner Rotations	The audit partner and the reviewing partner must rotate off an assignment every 5 years.
301	Audit Committee Independence	All audit committee members must be independent directors.
302	Corp. Responsibility for Financial Reports	The CEO and CFO must certify their periodic financial reports.
305	Officer and Director Bars	If received as part of fraudulent/illegal accounting, the officers or director is required to personally reimburse funds received.
404	Internal Control Reports	Management is responsible for an annual assessment of internal controls.
407	Financial Expert	One audit committee director must be a designated financial expert.
409	Real Time Disclosure	Financial reports must be distributed in a rapid and current manner.
1105	Officer or Director Prohibitions	The SEC may prohibit an officer or director from serving in another public company if guilty of a violation.

4 INTERNAL CONTROL

For many decades, internal control is considered as an important fundamental to a successful operation within not only the long-term run but also daily run of a business, because a key responsibility of a business manager is to control operations (Horngen 2012). Clearly, a sufficient internal control system which included right policies and procedures will able to assist and empower the company to achieve its specific objectives.

4.1 Definition and objectives of internal control

- **Definition**

It has been conclusively demonstrated that senior management of entities have been putting great effort into their internal control systems because of the vital role of internal control within their businesses, especially with accounting information systems. So, what is internal control?

Internal control means different things to different people (The Committee of Sponsoring Organizations of the Treadway Commission (COSO) 1994). Therefore, internal control is defined in many definitions since it impacts on the plenty of aspects of entities in various ways and creates some confusions amongst business owners, regulations and other stakeholders. Harrison argued and showed his opinion concluded in the definition about internal control which is as "*a system of procedures implemented by company management. It is designed to follow company policy, promote operational efficiency, ensure accurate, reliable accounting records and comply with legal requirements*." (Harrison 2011).

The most broadly accepted and wisely used definition about internal control, however, is found under a publication, named Internal Control – Integrated Framework (1994). This framework was established by the Committee of Sponsoring of Organizations of the Treadway Commission (COSO) which is one of the outstanding organizations established in order to develop recommendations for public companies and their independent auditors. COSO is a joint initiative of five sponsoring organizations which always have a strong voice as well as worldwide reputation for quality in terms of accounting and auditing aspects. Those organizations are as following: American Accounting Association (AAA); American Institute of Certified Public Accountants (AICPA); Financial Executives International (FEI); Institute of Management Accountants (IMA); and Institute of Internal Auditors (IIA)

Figure 12. COSO is a joint of five sponsoring organizations.

COSO defined internal control as:

> *A process, effected by an entity's board of director, management and other personnel, design to provide reasonable insurance regarding the achievement of objectives in the following categories:*
>
> - *Effectiveness and efficiency of operations*
> - *Reliability of financial reporting*
> - *Compliance with applicable laws and regulations.* (COSO, Internal control – Integrated framework 1994, p.13)

From the definition above, it is firstly noticeable that internal control is a process of improvement within a company. In order to achieve that improvement, the controls is strictly necessary to be under periodically-reviewed process or ongoing supervision to ensure company's continuous efficient operation.

The second key element points out that internal control essentially needs involvement of leading people within the organization. In other words, COSO sets straightly and importantly the role as well as responsibility of board of directors in the success of internal control process. Management, therefore, involving with internal control design, implementation and maintenance, is always required a plenty of discussions to build an effective control system.

Thirdly, the internal control definition given by COSO also demonstrates that internal controls are designed to provide reasonable assurance. It means that internal controls possibly cannot be established to provide an absolute assurance system for all risk and frauds which are able to happen in an organization. Internal controls exists itself with some inherent limitations. A sound and well-designed internal control system reduces, but definitely cannot eliminate risk and human error or mistakes. In fact, an ideal and adequate internal control system is the one that can provide to the company a reasonable assurance in a few crucial areas with helping company diminish material error, fraud, etc., but not one hundred percent certainty of helping company achieve its objectives and mission.

- **Objectives**

Objectives of internal controls are grouped into the following three categories, namely:

Operations objectives: These objectives involve to the effectiveness of organization's operations to achieve its mission and vision which are considered as the fundamental reasons for entity's existence. Operations objectives comprise operational and performance goals, and safeguarding assets and resources from loss with timely detection. (COSO, 1994, p. 34)

Reliable reporting objectives: These pertain to the preparation of internal and external financial and non-financial reporting with reliability, timeliness, transparence and recognized standard setters. These reporting, obviously are very essential in demonstrating financial status of an entity in purpose of providing information to all stakeholders; therefore it is required report with reliability and relevance. (COSO, 1994, p. 34)

Compliance objectives: These aims at complying applicable laws and regulations to which the organization is subject. Specifically, organization need to understand which laws and regulations that they must be fully compliant and, as far as possible, need to incorporate regulations into their objectives. (COSO, 1994, p. 34)

Three categories above seem to be distinct to each other because of dealing with different needs, but in fact, to some extents they are overlapping and sometimes very difficult to recognize which categories to place the problem in. Hence, board of directors need to be flexible, wise and foreseeable to deal with any circumstances.

4.2 Internal control components

According to COSO (1994, p.17), internal control comprises mainly by five inter-related components which are considered as criteria for determining and achieving an efficient internal control system. These components are derived in correspondence with management style and philosophy with difference from entities to entities, and are inseparable with management process. More importantly, the COSO also suggests some tools, guidance to help business evaluate and enhance their internal control system through those five linked components which are analyzed more in detail later.

Figure 13: Internal control components (COSO, Internal control – Framework 1994, p.17)

4.2.1 Control environment

As believed by Edward Chow (2005, p.10), control environment is the most important foundation of an entity not only in terms of internal control but also the whole operation since this factor encompasses and influences on its organizational structure and disciplines, objectives and risk assessment. In the other hand, the control environment "sets the tone of an organization, influencing the control consciousness of its people" (COSO 1994, p. 23). Control environment also reflects the common nuances as well as characteristics of an organization, dominates employee's control perspectives and then establishes the structure for entities as well as an ethical routine in work for people working there.

As usual, when companies develop greater in sizes or structures, the business owners will have to encounter more difficulties in managing, monitoring and controlling risks and fraud. Hence, the right attitude and sense of control over the management from business owners will create a plenty of strong influence on their business operating unit. Correspondingly, if owner or managers have clear perceive about internal control as an important issue, the staff will be in the hope of showing their respects to company's control process. Conversely, if managers do not really pay attention to the issue of their entities' control perspective, the control system certainly will not bring the desired effect. That is one of the reasons to indicate Edward's statement that control environment consisting of ethical values, competence of quality from human resources, and upcoming direction for the entity depends mostly on the board of directors and their managerial effectiveness.

It has been agreed that "*the core of any business is its people*" (COSO 1994). In detail, company's human resource with their integrity, ethical values and competence are considered as the most valuable asset to drive going forward and help company accomplish its objectives. Additionally, "*the control environment influences the control consciousness of its people*"; therefore, most huge corporations put a plenty of efforts on recruiting people with competence, enterprise-wise mindset of control consciousness.

From two statements above about people working in an entity and the way control environment effecting on, it is believed that the control environment play an essential role in providing and impacting on the atmosphere where people in the organization are able to carry out their working activities and responsibility. From that, a sound control environment of an organization can be reflected through an efficiently controlled organizational structure, appropriate policies and disciplines for example written code of conduct, teamwork style, etc.

Five Control Environment Principles

There are five factors building a control environment for an organization. Five of them are certainly as crucial as the foundations of a house and cannot lack of one factor. Yet, each of them can be varied in extent and priority in different entities. Those factors or principle will be showed by the figure below.

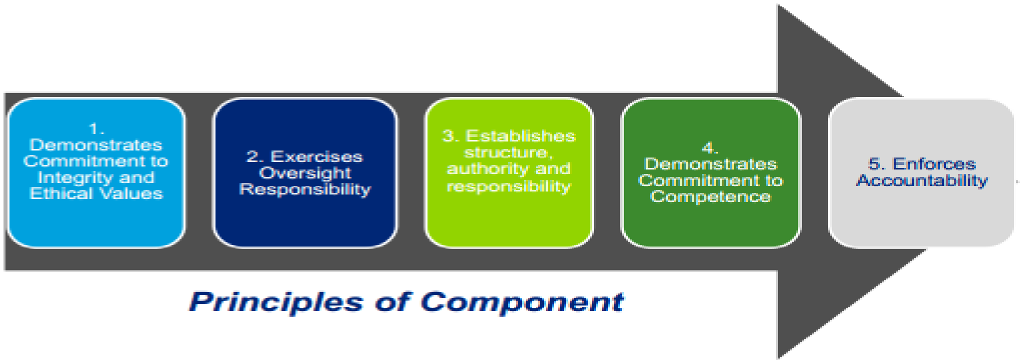


Figure 14: Principle of control environment (Deloitte training 2013, Adapted from COSO Internal control – Framework 1994, p. 53)

- Illustrating a commitment to integrity and ethical values – board of directors will be in charge of establishing the standards of conduct as well as mechanism for employee to follow; and determining the procedure and all resources of the organization in order to point out deviations on time.
- Exercising oversight responsibility – the board of directors of entity needs to be able to clearly understand their business and expectations from the company's inside and outside stakeholders which encompass employees, clients, investors, and other legal regulatory requirement from government. It means that board of directors have to take the oversight responsibility of internal control's development and performance into their concern.
- Establishing structure and authority – oversight responsibility is not only coming along with board of director, but also senior manager is. Together, they will set an authority structure in correlation with each personnel within the company. This will make company's operation clearer and smoother.
- Demonstrating commitment to competence – meaning that within the company, competence individuals in correlation with objectives need to be periodically

reviewed, improved. Organizations also should take concern to the plan preparations for succession in the future.

- Enforcing accountability – COSO mentioned that in this principle, accountability will be enforced through authority. Besides, organizations should have very clear policy towards accountability performance measure as well as reward system.

4.2.2 Risk assessment

The facts shows that regardless of variety of sizes, structures, industries, etc. Any business entities could not avoid the effect of risk. Risks can come from enterprises' inside or outside. The fact indicates that doing business is always going along with risk. The higher the risk is, the greater the profit can be attained. However, there is no measure could totally reduce all risks to zero when the profit is still existing. According to COSO framework, risk assessment is considered as the determination and analysis risks in related to the achievement of entities' business objectives, financial statement reliability and obedience with laws. Therefore, risk assessment can be seen as a basic foundation for how to determine risk management of that entities. More specifically, risk assessment and identification is a prerequisite for recognizing risk solutions. In order to have right decisions for the company's business, managers need to know the level of risk for each activity, and hence they can know which activity's decision can be accepted in correspondence with that level of risk.

Risk assessment principles

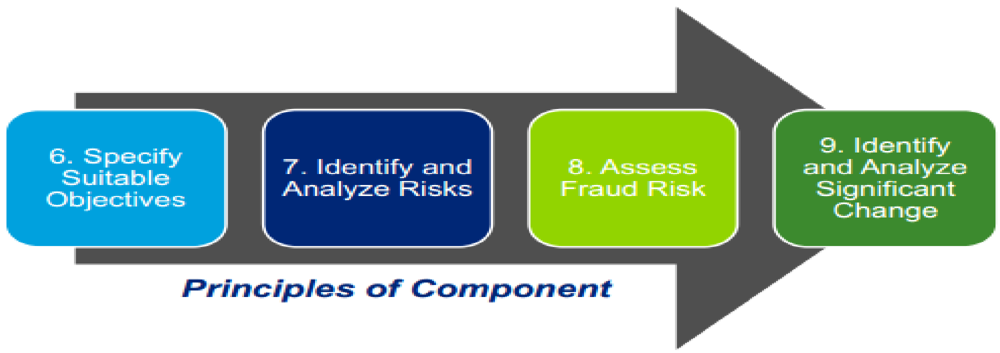


Figure 15: Principle of risk assessment (Deloitte training 2013, Adapted from COSO Internal control – Framework 1994, p. 80)

Content of the risk assessment includes four principles

- Specific relevant objectives – setting business objectives is not truly a component of internal control, but this activity is a prerequisite or an important basis for risk assessment. An event is considered as a risk to business if it affects or even threats to goals of the enterprise. Therefore, the first target of risk assessment is to set business objectives, then managers can identify risks in relation to goals and take necessary actions to manage them later in their ability.

- Identify and analyze risks – Risk identification is performed through the consideration of factors outside and inside the enterprise which can directly affect the operation of the business. Risk analysis is the consideration of importance and possibility of risks, which helps managers deal with risks, manage and mitigate their effects. Risk analysis method is very diverse since many types of risks are difficult to quantify. Yet, experts concluded risk analysis method with three basic stages as follows: assess and measure the damage from risk, then assess the probability of risk, and finally find solution to deal with risks.

- Access fraud risk – Potential fraud may create dangers for entities' objectives; hence fraud needs to be in the account of high consideration. Points of focus for this section are included attention of various types of fraud which can occur such as fraudulent financial reporting, asset misappropriation, corruption, etc.; access fraud's incentive and opportunities; last but not least, access motivation as well as rationalization as mentioned in the fraud triangle model.

4.2.3 Control activities

As stated in COSO Internal Control – Framework (1994, p.49), control activities are the policies and procedures to ensure that management directives are carried out. These policies and procedures aim to support other necessary activities to minimize the business risk and enable help objectives be implemented seriously, efficiently across the whole enterprise. Once managers is responsible for identifying risks, they are also in the primary responsibility for designing, implementing and monitoring of control activities to prevent or reduce the identified risks.

Types of control activities

- **Top Level Reviews –** Review is a comparison between actual performances with data from different sources. Thanks to review, managers are able to determine and handle the difference of interest. The purpose of this procedure is to detect abnormal fluctuations, quickly learn the root causes and propose corrective solutions in time. Some analytical methods of reviewed are such as checking data periodically in detail or collating data from actual inventory and accounting records, etc. (COSO 1994, p.50)

- **Segregation of Duties** – Segregation of responsibility or duties is referred as assigning tasks to different members among the organization. It means that at the same time one person should take duties at different works in place to reduce errors and frauds. For instance, salesperson would be responsible for selling product, but he would not have authority to change products' price. The purpose of the division of responsibilities is to create mutual control during operation, quickly detect errors and reduce fraud in the implementation process. This control activity, however, may be disabled due to collusion among employees; therefore, managers should examine and evaluate regularly the control activities and relationship among employees who work together to perform the task. (COSO 1994, p.51)

- **Information Processing** – To obtain reliable accounting information, managers must perform multiple control actions to check the authenticity, completeness and the approval of transactions. (COSO 1994, p.52)

- **Physical Controls** – The assets of a business may include cash, goods, equipment, inventories and information. Asset protection is very important since it prevents the loss, corruption, waste or improperly-used purpose. The rules and procedures for protecting the assets may comprise of restricting access the assets, using devices to enhance the security, checking Inventory of assets periodically, and preservation of documents and records in safe. (COSO 1994, p.52)

4.2.4 Information and Communication

It is believed that information and communication of control environment, risks, control activities and their implementation should be reported to superiors, and moved from top to bottom as well as horizontal line way in an enterprise. Information and communication consists of two components linked together. They are acquisition system which will process and record information and communication which enable help entity share relevant information internally and externally. (COSO 1994, p.90)

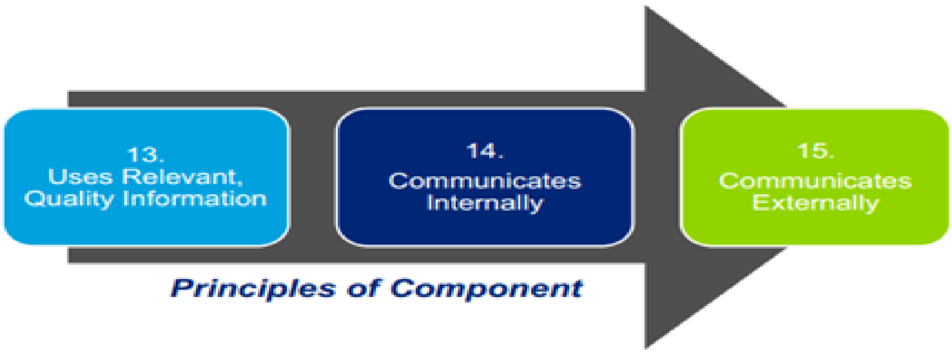


Figure 16: Principle of information and communication (Deloitte training 2013, Adapted from COSO Internal control – Framework 1994, p. 94)

Information

There is no doubt that information needs for all levels of business to support their operations and meet their objectives in terms of financial reporting and compliance. All information is used in businesses closely related to each other. For example, financial reporting not only is used for external stakeholders and public, but also plays a role in regard to business decisions or budgeting. Furthermore, quality of information affects managers' ability in terms of making decisions and controlling their business operation, it also indicates the adequacy of the appropriate data in the reports. (COSO 1994, p.92). Quality of information includes of:

- Appropriate information.
- Information is provided when needed.
- Information is updated timely.
- Accurate information.

- Information can be easily accessed by authorized people.

Communication

Communication is one of inherent properties of information systems. Communication is defined as the information provision to outside and in the organizations which comprises a different of ways such as from the top down to lower levels, from lower levels to higher levels, or among horizontally-related units. Internal control seems to be effective when the honesty and reliability and communication process is done accurately and timely. (COSO 1994, p. 93). Communication methods are very diverse in ways, for instance, implementation guide from managers to their employees, monthly newsletter, announcements, videos, sessions, seminars, meetings. Actions of managers can be also considered as a strong method in communication which has solid ad direct impact on employees.

As mentioned before, communication includes two major parts, namely communication inside enterprise and communication outside enterprise.

- **Communication inside the enterprise** – Financial management responsibility and other important operating activities always require clear and accurate information from senior management levels. The important tasks should be divided specific responsibilities. Each individual must understand the role, his responsibilities, how to perform the job to reduce as much as possible the risks and frauds which can be caused by unclear communications. At the same time, each individual also needs to understand the associations between his/her work with other people to be able to adjust mutual work in an appropriate way. Along with the communication from top to down, managers, in versa, also need to listen to the feedback from employees' ground in place to operate effectively their business.

- **Communication outside** – It is believed that communication is not only necessary within the enterprise but also outside its business. Shareholders, financial analysts, investors, and government who provide legislative requirements would understand difficulties that businesses have to scope through communication to outside. In addition, customers and suppliers can provide enterprise important information in the process of production or trendy demands which help the enterprise a lot in relation to ability to meet the growing needs of the market.

4.2.5 Monitoring Activities

Monitoring is the last part of internal control which is referred as "*a process that assesses the quality of the system's performance over time. This is accomplished through ongoing monitoring activities, separate evaluations or a combination of the two*" (COSO 1994, p.69). Monitoring plays of course an important role in the internal control system, it helps control internal maintains its effectiveness over different periods. The supervision activities are conducted by those who have responsibilities regarding to reviewing the establishment and implementation of control procedures. Monitoring is done in all activities in the enterprise and in two ways: ongoing monitoring and separate evaluation.

Ongoing monitoring

Ongoing monitoring activities take place during the operation of business by managers and employees. Regular monitoring is often applied to the important elements of internal control. This type of monitoring aims to assess the performance of routine activities and thereby to review the internal control system's efficiency. The evaluation criteria for enterprise monitoring include:

- Gather information within and outside the enterprise to clarify issues arising from internal or other internal information through the organization of training sessions, seminars or other forms of encounter to provide feedback to the manager
- Compare the actual data with bookkeeping data.
- Internal audit and independent auditors – focus on the recommendations for improvement of internal control from independent auditors and internal auditors.

Separate evaluation

Separate evaluation is recommended that this activity should be carried out periodically through internal auditing function and independent auditors. Thanks to this, detection of weaknesses in the system could be recognized timely and thereby make improvement measures for those weaknesses. Scope and frequency of monitoring depends on the level of risks as well as importance of the controls in minimizing the risks. The higher risk's ability is, the more frequently monitoring will be carried out. Besides, monitoring range depends on the operational objectives, financial reporting in compliance. (COSO 1994, p. 71)

The evaluation of the internal control system itself is a process. The person being in charge of assessment must be knowledgeable in all internal control's activities, and also know how to determine the best way for the system. There are many methods and assessment tools for evaluation such as checklists, questionnaires, flowcharts, or comparisons to other similar businesses in the same industry. (COSO 1994, p.72)

4.3 Types of internal control

According to Tommie and Aaron (2010, p.137 & 138), control usages can be broken down into three different categories as follows:

- **Directive controls** – are those established for company's desired outcome with a clear direction and strong drive to obtain its objectives. This kind of internal control is associated to high level of directions with positive arrangements to encourage employees as well as clear direction to guide them. Directive control may involve to the state laws and regulation, company's policies and standards, even some training programs, etc.

- **Preventative controls** – are considered as control procedures which designed to attempt preventing the undesirable violation or conditions leading to irregularities and fraud from occurring. In other words, this control avoids the loss or harm before them happening to minimize the fraud risk. Preventive control is usually applied within the daily work of employees in accordance with their differences in functions and responsibilities, such as the division of responsibilities and obligations; mutual supervision; checking the validity and the accuracy of work. Example may include avoiding the same person who is in charge of above two procedures of accounting work, such as recording transactions and also making purchase. Another example maybe like one employee submits a payment for company's purchase, it is better to have another person for authorizing that payment**.**

- **Detective controls** – the purpose of this kind of control is to identify or recognize errors which may already occurred, were out of prevention. Experts stated that detective control is to some extent cost-consuming than other method, yet it is still referred as a necessary control tool as it can measure the preventive control's effectiveness. Auditing is one of the bright example for this kind of control usage. Besides, there are other examples for detective controls such as supervisor review, internal checks, account review and reconciliations, etc.

In Tommie and Aaron's opinion (2010 p.138), detective control and preventive control are closely-related complements. As mentioned before, strength of preventive control is to prevent the mistakes or errors before they can exist; hence, the damage can be in the hope of reducing and save many cost of fraud risk. The fact, however, shows that there is no single control can reduce all risks of fraud to zero or no entities can be totally immunity of errors and frauds, there is a highly-recommended solution that any organization should design such combination of control usages from 2 out 3 types of above controls. For instance, an association between preventive control and detective control usually used the most in the business world because of its advancements. In more detail, preventive control is responsible for avoiding as much as violations, and then detective controls will help detect errors which are conceded from control of prevention, and importantly, increase attentions and responsibility of staff in the process of implementing preventive control.

4.4 Importance of internal control in reducing risks of frauds

One of report from KPMG (2010) indicated that a poor internal control as well as override of internal control are the two main factors helping frauds occur more easily. Hence, a strong internal control system will be the best protection from fraud to every organization, especially small business entities which are the victims of frauds in the most damaged way. The figure below conducted by KPMG shows that fact.

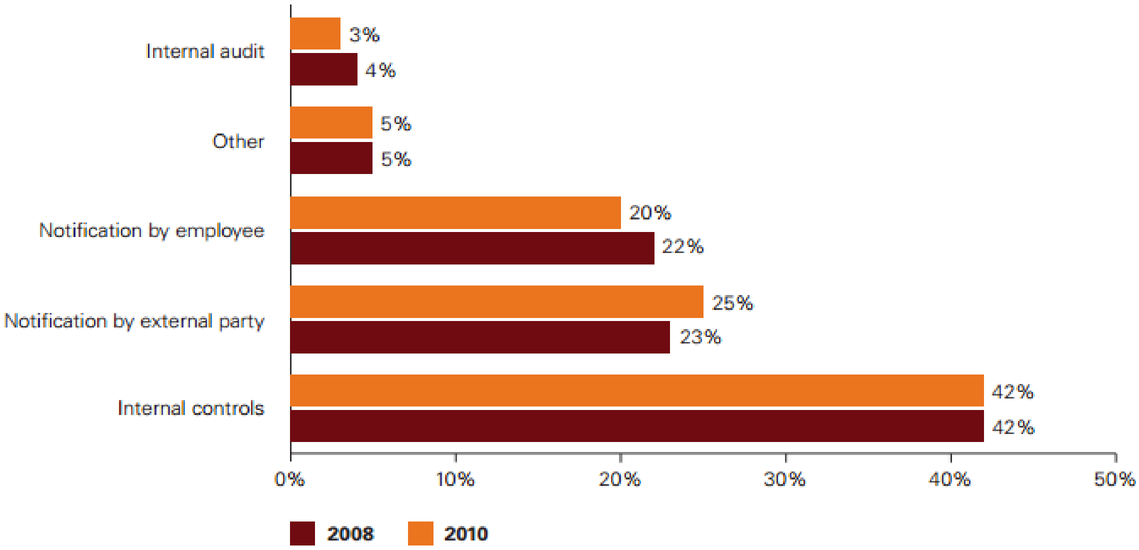


Figure 17: The detection of largest fraud KPMG, Fraud and misconduct survey report, 2010, p.12)

From the figure, it can be seen that the most efficient tool to detect fraud is the internal control implemented within enterprises. Therefore, establishing and designing a sound internal control system are able to help businesses prevent and reduce the risk of fraud (IFAC 2012, p.5). However, internal control application to a large entities comparing to a small ones certainly has the differences in terms of internal control's components because of their diverse in organizational structure, number of employees, etc.

5 RESEARCH METHODOLOGY

5.1 Research methods

The research aims to achieve greater understanding of the current internal control situation and perception towards fraud of employees at D, and thereby recommend some improvements for fraud prevention, especially financial fraud prevention in correspondence with internal control system of company D. In order to meet research objectives, author indeed has to be careful in terms of choosing the most appropriate method strategy for the research. Mark & Philip (2009, p.141) suggested that there are seven research designs, namely experimental design, survey design, case study design, action research design, grounded theory design, ethnography design and finally, archival research design. As research aims mentioned above, author decided to choose case study design as the main methodology research design for her paper.

Case study design in Mark & Philip's definition is "a strategy for doing research which involves an empirical investigation of a particular contemporary phenomenon within its real life context using multiple sources of evidence" (2009, p.146). In other words, case study design involves in-depth, contextual investigations of matters of a phenomenon. This research design is highly recommended in case of researchers wish to obtain a rich understandings of the research context. In addition, the most highlight advantage of this strategy is that it helps researchers be able to extensively gain answers to some questions such as "why?", "what?" and "how?" in their research questions or hypothesis. Because of its usefulness, case study design nowadays is used in the most explanatory as well as exploratory research. (Mark & Philip 2009, p. 146)

The data collection techniques for the case study design are plainly various from qualitative to quantitative technique, yet qualitative method are seemly more in use than quantitative one in this type of research design. In more details, searchers can employ interviews, observation, documentary analysis or questionnaires for their case study to reach the in-depth view towards their real life case. According to Mark & Philip (2009) qualitative research methods are seen as the most appropriate technique in case of researcher needs to understand deeply about perceptions or feeling of the respondents. Since this research mostly concentrates on the perceptions, opinions, and evaluations of all employees working at company D (the case study) about their company's internal control system and their consciousness about frauds, author decided to use two qualitative research methods. Those methods are **questionnaire method** and **interview methods** which are considered as the best suitable methods in author's opinion.

Besides acquiring the primary data through conducting questionnaire and personal interviews, secondary data from professional guidelines as well as books are appropriately used in this research. In short, the research results are the outcomes of a mixture of primary data and secondary data.

5.1.1 Questionnaire

Questionnaires' advantage can be seen at the point of acquiring primary data more efficiently with saving time, energies and costs. It is also an effective technique in case of a research is coping geography difficulty, for example, in this paper the distance between the author's place and company case study location would be solved when using mail questionnaire method through internet. In addition, this method is considered as an appropriate approach to be used in the case study research design (Mark & Philip 2009, p.360).

According to Mark & Philip, a questionnaire "is a reformulated written set of questions to which respondents record their answers". In terms of ways of questionnaire delivery, there are two types of questionnaires as following

- Personally administered questionnaires – one of the most frequently used methods for collecting data when the survey is confined to a specific local area. The major benefit of this method is about the time-saving, meaning that researchers can collect all the completed answers from respondents in short time.
- Mail questionnaires – as mentioned above, mail through internet shows it best advantage when the research has difficulty relating to geographical matter. This kind of method is plainly simple and cost-effective as well. Researchers set a written of questions in advance, then the questionnaires are mailed to relevant respondents who are able to complete the questions at their home, their working place with conveniences.

Due to benefits from mail questionnaire, the author took this method for use in her paper. The Author's questionnaire with set of questions regarding to internal control system at company D. Thanks to the helps of Ms. Ashley Le – sales manager, the author could have the mail list of people working there. Definitely, respondents the author chose are all the official employees working at D who involve the most in the working environment at D and also relatively have perceptions to some extent about internal control of D. With the relevant respondents for the questionnaire, the author is in the hope of taking the most valid and reliable understanding and knowledge about internal control system at this company.

After contacting to all respondents, the author sent the questionnaire to them. This questionnaire has twenty five questions with six categories divided as five components of an internal control system and fraudulent perception. The six categories are control environment, risk assessment, control activities, information and communication, monitoring and last but fraud overview at D.

The questionnaire was created on 10th of March 2015 by using Google Forms service with the link (see appendices): https://docs.google.com/forms/d/1FQ-IzvNtyBLmLjKObLJ5CdCXWRnsYb5z9gWSc8o0bTU/viewform.

This questionnaire was sent by email to respondents. After three weeks of waiting, the author received sixteen replies out of forty people. It means that the received ratio of this questionnaire is only around 0.4 percent which was not high as the author expected. Nonetheless, from result based on each questions of questionnaire, the author did have some understanding foundations about D's internal control in relations to fraud matter. This questionnaire indeed was a direction for the author to make further analyses.

5.1.2 Interview

As mentioned above, interview method is a primary data collection technique. In more detail, this method is referred to gather qualitative data on the issues of perception or interest. According to Donald & Pamela (2014, p.152), interview would be the best useful method for researcher if the study is on the exploratory stages of research. Meaning that, the use of interview empowers researcher to acquire valid, reliable and updated data in order to answers research questions. Also from Donald & Pamela's opinion, they suggest that there are three smaller categories of interviewing method, which are unstructured interview, semi-structured interview and lastly structured interview.

- Unstructured interview – referred as an informal interview with no specific questions or order topic to be discussed. This kind of interview is usually used when researcher would explore in depth an overall topic or area in his/her interest which is kindly flexible and changeable depending on the respondent's answers.
- Semi-structured interview – some of theme and questions in the interview would be in order or pre-determined in advance in order to obtain relevant information, and the rest should be flexible as in the unstructured one for the purpose of exploring other responses further.
- Structured interview – this type of interview refers using a detailed and standardized set of questions in the interview session, thereby structured interview could be also considered as quantitative research interviews when it is used to collect reliable and quantifiable data in a highly predetermined way.

In this paper research in correspondence to the case study, the author employed the semi-structured interview approach with the wishes of acquiring the most valid and reliable information about company D's internal control system. Since the author is now conducting her paper in Finland, yet the case study is about company D which is located in Vietnam, it was difficult for the author to arrange a face-to-face interviewing session with company's D representatives. Consequently, the interview was accompanied via email exchanges. After contacting to the right representatives of company in Vietnam, the author received the participating agreement from them. The author, then in the beginning, introduce briefly about the research ideas as well as objectives. After this stages, the author started asking further questions to fulfil the author's need of the research. Obviously, this email interview method is plainly time-consuming because of some delayed time; however, this approach would allow both the author and representatives have more time in advance to review carefully regarding to questions being asked as well as answers being delivered.

5.1.3 Secondary data

The fact shows that when considering how to meet objectives of a research, some researchers, mostly students, usually think of using existing data or reanalyzing data in the books, from the internet, etc. which are partially linked to their research topics and research questions. Those existing data is defined as secondary data, which in detail "is information gathered by someone other than the researcher conducting the current study". (Mark Saunders & Philip Lewis 2009)

The secondary data can be referred as an empowered technique to researchers for its usefulness in the stage of initially understanding deeply towards research questions. Thereby with the combination of primary data collection, secondary data truly can help researchers obtain research objectives. Furthermore, using of secondary data sources is less time-consuming and more cost-effective for researchers regarding to gaining information. For secondary data's convenience, in this research, author used several sources of secondary data such as books, published surveys, journals, guidance and statistical abstracts, etc. Moreover, since this paper analyzes company D., some internal sources of this company also in use, for instance, D's website with blogs, articles, D's annual reports, etc.

5.2 Creditability of Research Findings

All researchers thirst of reducing the possibility of getting answer wrong. They indeed have to pay high attentions according to what research design should be chosen and used. Type of research design being selected would impact intensely on reliability and validity of the research. (Mark and Philip 2009, p.156)

5.2.1 Reliability

Mark (2009) stated that reliability refers to the extent to which data collection techniques and analysis process will be consistent findings. In other words, reliability is an indication of the stability and consistency which could be understood that the research result are getting consistent over time and even if it is re-conducted by other researcher, the result of that study should be similar and constant.

The use of reliability are frequently noticed in a qualitative research since qualitative research tends to involve tightly to measures and consistency. This paper was mainly employed qualitative research instruments; therefore author paid her high considerations towards reliability of her research. Mark and Philip (2009, p.156) suggest that there are four major threats to reliability, which are participant error, participant bias, observer error and observer bias. Generally, these threats are originally rooted from human error and human bias, either from participants or observers.

Avoiding all human error and bias seems to be impossible to the author in this study. Yet, the author attempted her best ability to minimize these threats in place to get the most reliable results. About questionnaire, its contents were written in a tight order, easily to understand and friendly used-wording manner, it means that the author would try as much as possible to create the comfortable atmosphere for respondents when answering questions. Moreover, since the questionnaire was conducted through emails, respondents could feel freely to take and answer it whenever they would like to do. Saying about interview method, as said before, the author took semi-structure interviews in the purpose of creating the freedom for interviewee to express their views in their own terms as well as encouraging two-way communications.

With the enthusiastic supports and helps from two managers at company D in terms of providing numerous materials and their point of views, as well as the author's carefulness regarding to carrying out questionnaire and interviews, the author truly believed that research findings are greatly reliable and the threats from human bias or error would be the least minimized.

5.2.2 Validity

Mark (2009) defined validity that "validity is concerned with whether the findings are really about that they appear to be about". Simply speaking, validity measures how truthful the research findings are (Mark & Philip 2009, p. 157). Validity is one of the major considerations in doing research since any research could be influenced by various outside factors which can invalidate the research results.

According to Donald & Pamela (2014, p.257), validity is broken down into two smaller forms, external and internal validity. While external validity of search results refers to the data's ability to be generalized or applied to other people or settings, internal validity is about ability of reflecting how confidently a variable can conclude. Two both types of validity could be threaten by some elements such as history (time factor), testing instrumentation, mortality, maturation, and ambiguity about causal direction.

Understanding the importance of validity of research findings, the author put a plenty of effort in order to eliminate threats for validity. By gathering reliable information from two primary data collection techniques - questionnaire and interviews, as well as adequate materials from company D's website, this research results are to be in high validity with a real reflection what is currently existing within the case study company D. Moreover, due to the analyses based on reliable material, the final outcomes not only are applicable, but also help company's managers learn more about further aspects at their company internal control system in relation to risk of fraud and thereby find appropriate solutions to reduce it.

5.3 Limitation of research methods

Regardless of the author's attempt to produce the most adequate results, this research still suffered several limitations. Firstly, geographical matter is one of the most difficult the author has to cope with. The case study company D is located in Vietnam while the author conducted the research in Finland. For that reason, the author did not have opportunity to take the best practical observation by eyes for the company D. Secondly, due to far distance difficulty, the author could not set a face-to-face interviews with managers, thereby the time of waiting for answers from them was taking longer than the author expected which was last this research longer in time. Thirdly, the topic of this research is to some extent associated to fraudulent matter which is moderately sensitive and confidential information; hence, some issues relating to ethical standards were hardly to explore. Last but not least, the number of respondents for the questionnaire was not high, yet time schedule for this research was somehow limited, the author had to be accepted the low ratio and used it for her further analyses.

6 RESULTS

6.1 Internal control and anti-fraud awareness at D

The author used questionnaire to ask employees currently working at D about their perception towards fraud matter and five components of the internal control standard suggested by COSO Integrated Framework. Five components consist of control environment as well as other elements such as risk assessment, control activities, information and communication within the enterprise and monitoring activities. Other materials available in the website of D also was employed to obtain in depth a general picture of internal control system as well as practices about fraud issue at D.

6.1.1 Current state of internal control at company D

6.1.1.1 Control environment

- **Management's philosophy and operating style through FAST ERP and internal policies**

Since the beginning of its establishment, D was operated by Mr. Gilles Ferrero as the CEO of the company. The CEO and board of directors of D always put the delights and satisfactions of customers as the highest achievements for the company. In order to achieve the customer satisfactions and minimize the risk of fraud within the company, the CEO has been using an Enterprise Resource Planning (EPR) program to help in terms of control and directing his business, that program is called FAST ERP. As mentioned in the background of D, the company's finance and accounting department is currently using FAST accounting software to record and control transactions. The reason for using this accounting software is not only because of its advanced functions for small businesses, but also its compatible association to FAST ERP program which empowers the CEO or COO to access almost business functions with D such as accounting, sales, purchasing, CRM (customer relationship management), or HRM (Human resource management), etc.

Figure 18: FAST ERP program, current used at company D (Hong Le – Finance manager at D, 2015)

Asking about the ethical standard which included integrity and transparency of management class at D, among 16 respondents, 11 of them which account 68.8% stated that the level of integrity and transparency of the CEO and board of directors are in the high level, even 6.3% thumb up with the highest level. 18.8% of them feel that the CEO's integrity is just around medium range.

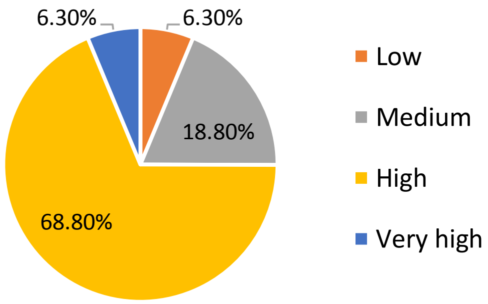


Figure 19: Which level of integrity and transparency do CEO and directors show in their work? (%)

Meetings between the enterprise's leaders and their subordinates is considered as an important element of business management, and through meetings the CEO and manager are able to dedicate their voices and management's philosophy to employees by communicating, building teamwork or solving problems. At company D, the CEO and board of directors usually conduct meetings monthly (68.8%). With several functions, meetings could be carried out weekly (12.5%), yet other functions only needs meetings once a year (18.8%), and there is no respond for quarterly meeting.

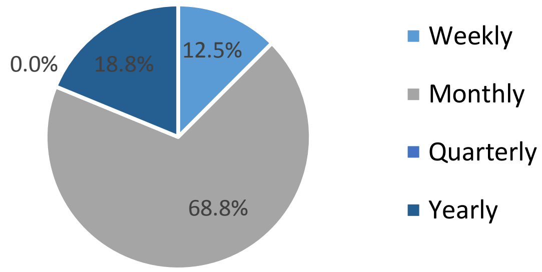


Figure 20: How often does CEO or board of directors have meeting with departments and employees? (%)

.

- **Organizational structure**

Organizational structure of D was showed by the diagram as follows:

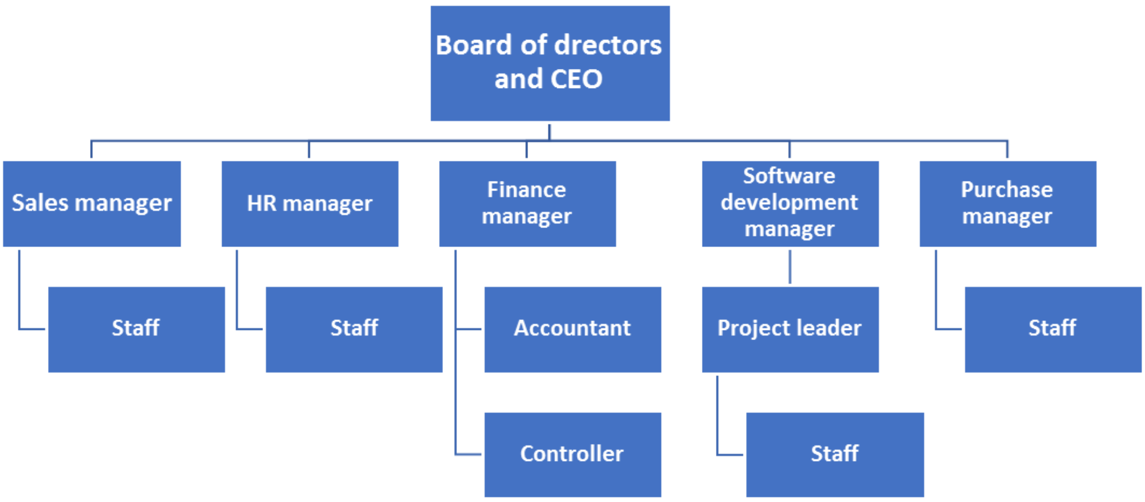


Figure 21: Organizational hierarchy of company D (Adapted from Hong Le's material about human hierarchy at company D, 2015)

At D, there are five major departments which are leaded by the CEO. Each department has its different functions and responsibilities. These five departments need to have a closely tight relationship among them in order to ensure the company's operating effectiveness.

Sales department – Sales manager will be in charge of this department's workload as well as its efficiency. Sales employees will take responsibility for public relation job or marketing for products and services of D. They are also people of receiving orders from clients and finding new customers for the company.

Human resource (HR) department – be responsible for recruiting new human resource, checking the salary calculations from the accounting department, arranging vacations and sick leaves for all employees.

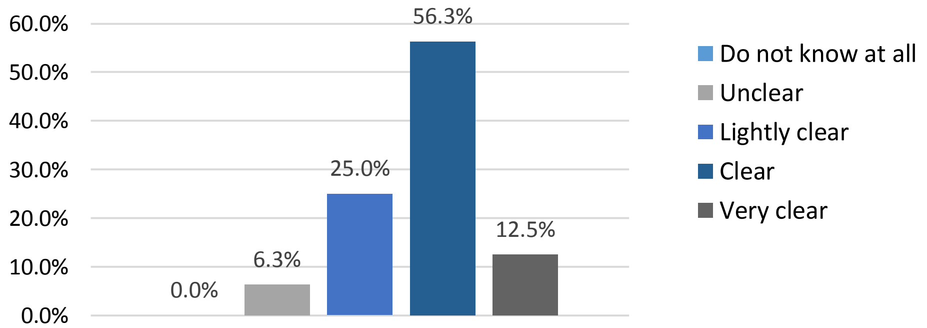
Finance department – leaded by finance manager. Main responsibilities are bookkeeping, producing monthly and annual financial reporting to outside stakeholders and investors, researching new investing opportunities for D. in the future, advising to CEO regarding to finance activities.

Software development department – this department is the key opponent of the company. Gathered by excellent Information Technology engineers from different countries. Main work of this division is running software projects to customers or outsourcing IT service to them based on their demands.

Purchase department – In the duty of purchasing products which will be resold later. Purchase procedure comprises of planning, finding the best vendors, ordering and receiving products and saving products' data into Enterprise Resource Planning system. Purchase manager also has a team for market research whose main purpose is about obtaining promise products from customers' need.

- **Assignment of authority and responsibility**

As the results asking about the clarity of employees knowing about their job descriptions which also means how well the employees know about their jobs as well as their responsibilities, 56.3% stated that they know clearly, following is 25% of them saying



they know it slightly. 12.5% of respondents certainly know what they are supposed to do in their job; however, 6.3% are unclear about that.

Figure 22: Which level of clarity do you know about your job description? (%)

Besides the clarity of job description, the clarity of authority and responsibility division of each employee is also mentioned in the questionnaire. The outcome is indicated that as the followings:

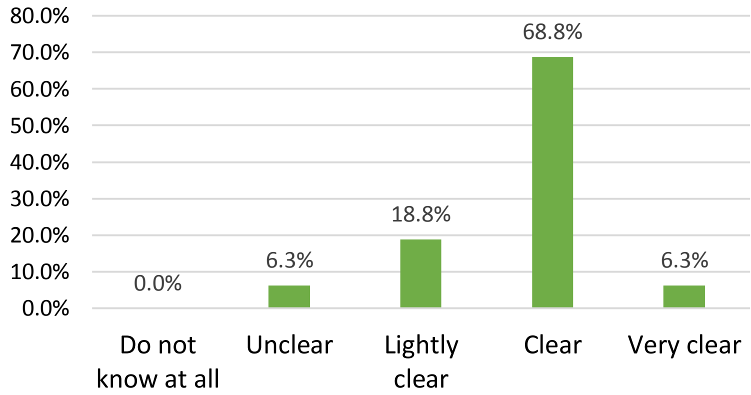


Figure 23: Which level of clarity in the division of authorities and responsibilities of each person in the company? (%)

- **Human practices and policies**

From the summary of responses of question about employees' positions and their number of years of experience, the author realized that there are three departments have the most number of staff in the company, which are software development department with its IT developer having from 2 to 8 years of experience at D, sales department with its sales staff having 1 to 3 years of working at D and finally, purchase department comprising of purchasing staff with 1 to 3 years of involvement.

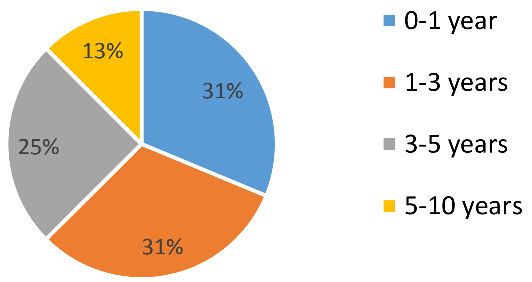


Figure 24: How many years have you been working in your company? (%)

In relation to the question about internal regulations and policies, the respondents answered that most of them have a moderate and even full knowledge of their company internal regulations as well as policies.

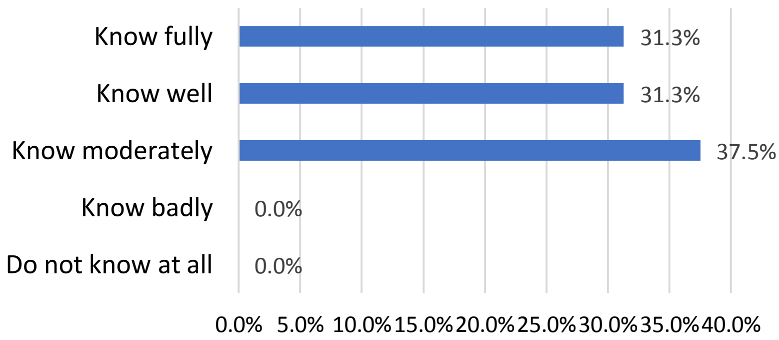


Figure 25: How well do you know about your company's internal regulations? (%)

Several human practices in regard to control environment existing at D are dedicated through questions asking about personnel records and recruiting and training process.

More specifically, over 2/3 employees do not know whether their professional capacities were saved in the company personnel records or not, only 1/5 of respondents know about that matter.

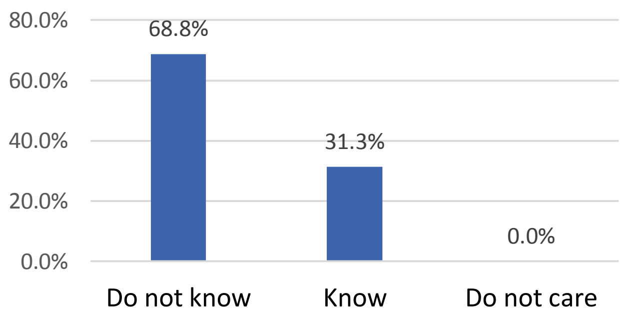


Figure 26: Have professional capacities of employees been saved in personnel records of the company? (%)

In detail about recruiting and training, 50% of respondents said that they had the training before officially working at D, yet 31.3% of them did not have such of training, and 18.8% did not know that their company have offered training for new personnel.

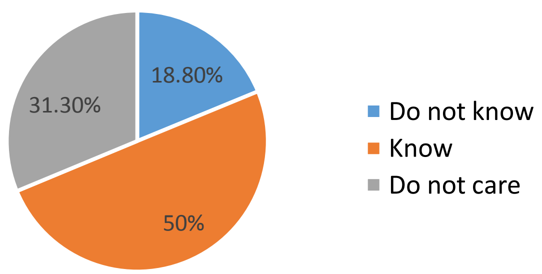


Figure 27: Did the current staff undergoing the process of recruiting and training? (%)

6.1.1.2 Risk assessment

- **Specific suitable objectives**

In this section, the author would like to obtain the employees' awareness of the company's operating objectives. As the result, 50% of respondents stated that they did know about this term, 25% of them either do not know or do not care about that.

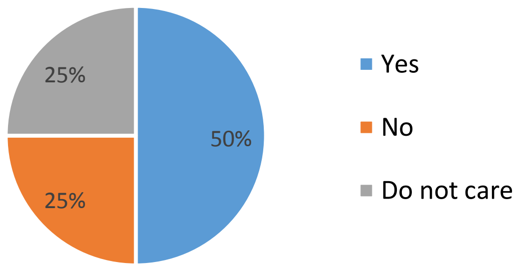


Figure 28: Do you know your company's objectives? (%)

Furthermore, as regard to determining objectives' important level at company D, 87.5% of responds showed in "yes", the rest said "no".

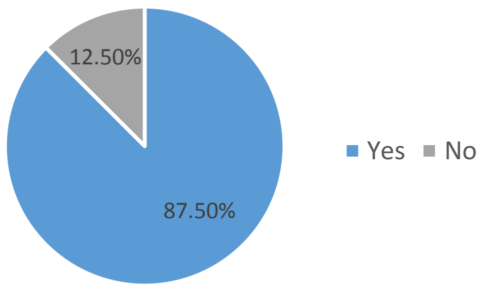


Figure 29: Does the company determine its objectives' important level? (%)

- **Identify and analyze risks**

It seems to show that identifying and analyzing risks plays important role in the business survival. For that reason, when asking about this activities, 94% of respondents believed that their company usually conduct the analysis between risk and profit for any potential project or business activity.

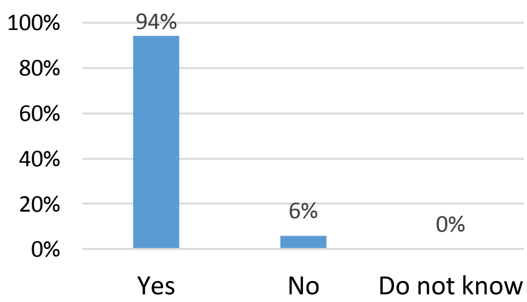


Figure 30: Does the company often analyze risks and profits for a potential project or business activity? (%)

6.1.1.3 Control activities

- **Performance review**

Among 7 of 16 respondents which account for 43.8% chose that their company usually conducts the comparison between data in reports and real outcome, following by 31.3% of them said this work is conducted often, 12.5% chose the option of "always", the rest vote for "rarely" and "sometimes".

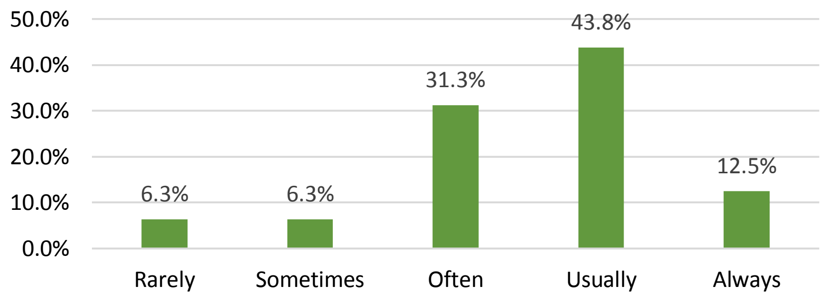


Figure 31: How often does your company compare between data in reports and real outcomes? (%)

- **Physical and data controls**

It has been believed that the protections of company towards assets and internal information is a fundamental in order to reduce risk of fraud. When asking about this matter, most of respondents (9/16) evaluated that their company protection for assets and internal data is just around moderately certain level. Several of them which account for 18.8% and 12.5%, however, felt that the company has a certain, even strong protection for the company tangle and untangle assets.

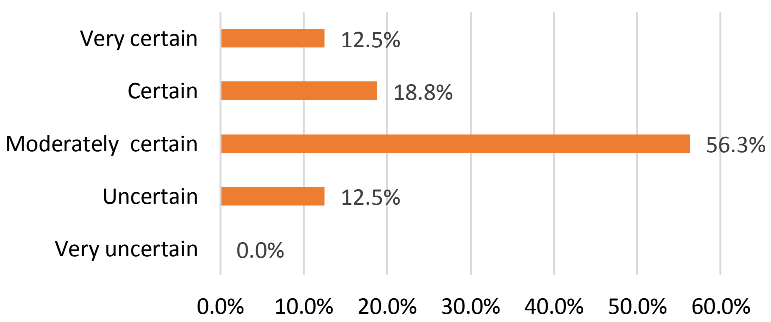


Figure 32: How strong of your company's protection towards assets and information? (%)

- **Segregation of Duties**

As discusses in the literature review, segregation of duties is considered as an essential activity which management level have to focus at the beginning of control activities. The outcome from the questionnaire shows that the clarity of division of task within the company in order to reduce risk of error or inappropriate actions is in the level between “unclear” and “lightly clear”, respectively account for 12.5 % and 56.3%. Nevertheless, 1/3 of responds chose “clear” option (31.3%).

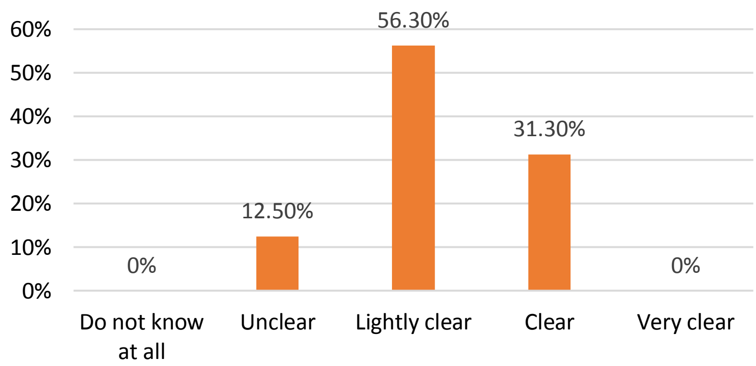


Figure 33: The clarity of division of tasks for each employee in the company? (%)

6.1.1.4 Information and Communication

- **Information in relation to error or fraud**

When an error or a fraud occurs, most of employees tend to announce that problem immediately to their managers with 93.8% of respondents said “yes”, only 6.3% said “no”.

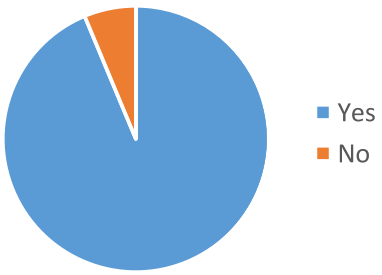


Figure 34: Does employee immediately report to manager when a problem/error occurs? (%)

Customer complaints are always the bad news to the company since the objectives of D aims to customer satisfaction. Therefore, whenever there is a complaint from customer, employees and managers are hurry to check and find reasons for that error. 100% of respondents stated that the company always attempt to find reasons of customer complaints and reimburse to them to fix the problems if needed.

- **Internal communication**

To minimize the risk of fraud, board of directors seems to give out a policy in terms of encouraging employees to report to managers any reasonable suspicions within the company. 94% of answers said that they are encouraged to do that, only 6% in vice versa.

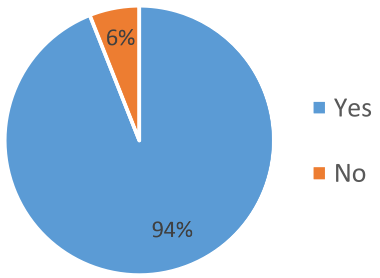


Figure 35: Are employees encouraged to report any reasonable suspicion to managers or CEO? (%)

6.1.1.5 Monitoring

- **Ongoing monitoring**

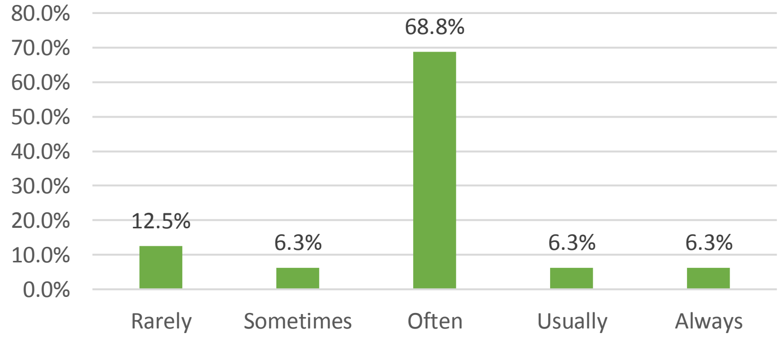


Figure 36: How often does the CEO check departments' activities as well as employees' activities? (%)

- **Separate evaluations**

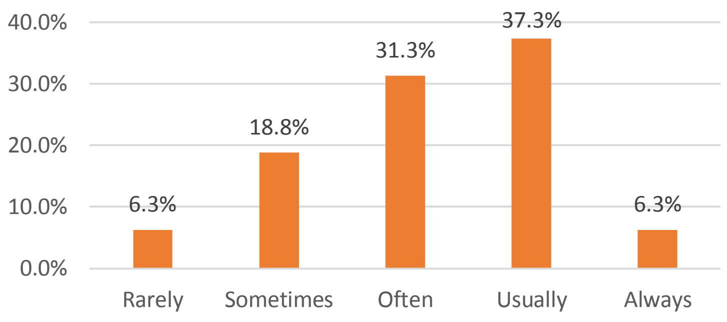


Figure 37: How often does company's managers check and review employees' performance? (%)

6.1.2 Anti-fraud awareness

- **Fraud history at D**

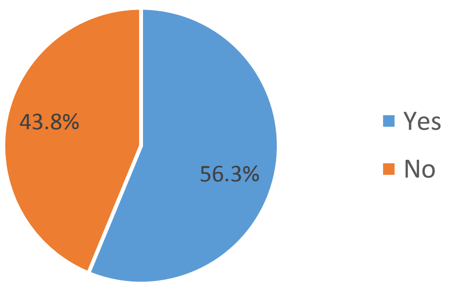


Figure 38: Has the company had any cases of fraud or theft occurred before? (%)

- **Moral values and attitudes at D**

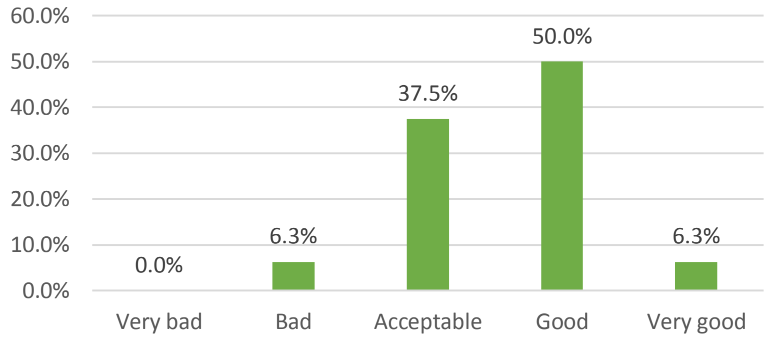


Figure 39: What do you think about leading styles and moral values of the boards of directors? (%)

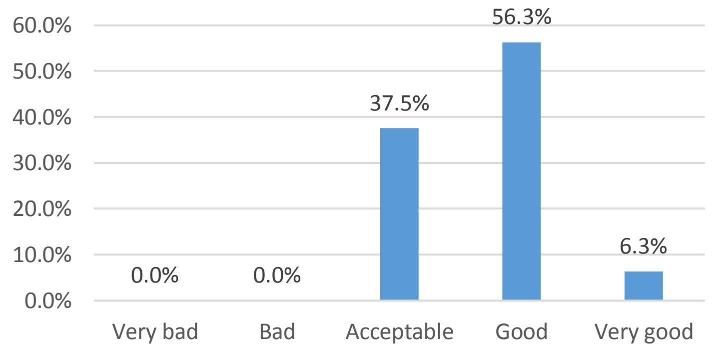


Figure 40: What do you think about your colleagues' moral values and attitudes? (%)

6.2 Current control practices at D

In addition to the questionnaire, the author employed interviewing method in place to obtain greater understanding about three major functions at company D. Hence, this part presents the results and findings of interviews. The aim of the interviews is to achieve the in depth managerial practices existing within three main departments at D which are the most vulnerable functions effected by fraudulent activities; the focused functions are sales department, purchase department and accounting department. Besides the current practices, the interviews also asked to approach managers' point of view towards fraud matters.

6.2.1 Control practices at sales department

- **IT outsourcing service**

As mentioned in the background of D, outsourcing service plays as the mainstay of the company's revenue. To reach customer satisfaction, this service is the articulated combination between sales team who are responsible for contacting and communicating with customers and IT software development department who are in charge of designing IT products to meet customers' requirements.

Obviously, sales department are the representatives of the company in front of their customers. Sales employees directly contact, take orders from clients, record sales transactions and finally receive the payments. Those activities, generally speaking, are directly associated to revenue of the company and it is believed that sales department needs to be under constricted control since its environment and working conditions are in high possibility of fraud commitments.

As the result from the interview with Sales manager – Ashley Le, the author withdraw several findings in relation to control practices at Sales department as followings:

Number of employees – there are four sales employees for IT outsourcing service whose experience from one to two years. They are under management of Sales manager who only has over one years of working experience at D.

Kinds of contracts with customers – company D is using two types of contracts depending to kinds of IT products or projects delivering to customers, fix-priced contract and flexible contract. In detail, fix-priced contract, as it is called, is a contract with a fix price where payment from customer is unchanged regardless of amount of material and time expense. Clearly, fix-priced contracts support customers in terms of determining the total price in advance without considering it in the future even when the materials and time elements change. About flexible contracts, they are obviously opposite to fix-priced contracts. This kind of contracts allows customers to pay the payment based on the amount of works performed by human resources, materials used and time consumed. The total payment of flexible contract would be done when the projects or products completed. This distinction of kinds of contracts helps D properly forecast in the human resource usage for each project or product, thereby prepare a long-term plan in advance in allocating human resources as well as materials.

Sales cycle – through interviewing, Ashley said that a well-managed sales cycle indicated a healthy business. Sales cycle is a series of phases designed to attain the best result in selling a product or service to customers. Apparently, sales cycles are various in way of designing phases because of the difference in products or service or difference in size of organizations, etc. At company D, the CEO and sales manager together established a sales cycle for IT outsourcing service which they think this sales cycle is a proper cycle for their business.

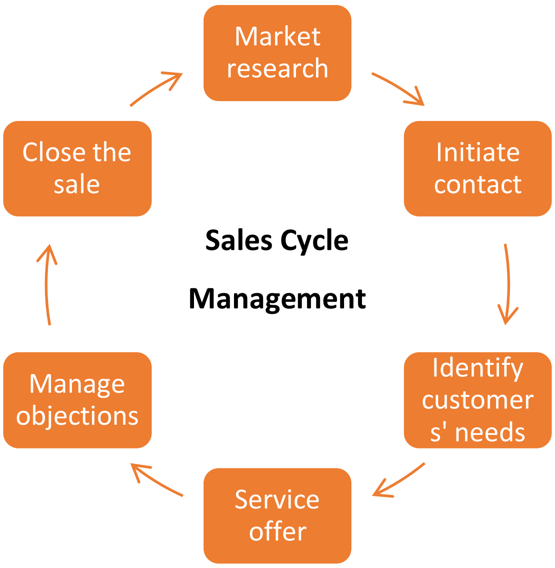


Figure 41: Sales cycle for IT outsourcing service at D

Cash collection process/ Accounts receivable – this term referred as a process demonstrating how long it takes to collect receivables. It is no doubt that the sooner business can be able to collect money, the shorter the cash collection cycle is (Ashley Le, 2015). The following would show the cash collection cycle currently used at D:

Figure 42: Cash collection cycle using for IT outsourcing service at D

- **Retail**

Besides outsourcing service, the company is also providing customers with retail or merchandise service. This service is the second income source of the company. Their main products selling to customers are computers and computer-related accessories such as mouse, keyboard, memory card, adapter, etc.

The retail store is located at the same office building with the company. This well-located condition allows sales manager and purchase manager control more easily in terms of purchase cycle, sales cycle and billing cycle.

Number of employees – There are two sales staff at this store and one person being responsible for delivery service. Salespersons are responsible for taking care of products, customer service such as helping customer select products, advising customers by providing product information. Moreover, retail salespersons are also in charge of checking the inventory for the next purchase for the store. These job descriptions seems to be relevant and clear to them; however, there is an unclear job duties between this two sales employees. They have the similar job descriptions and are able to alternate their work for each other, but not transparent responsibility in work.

Shopping solutions for customers – Customers of D retailing service could have two options for their shopping. They are able to either directly go to D store and buy products, or call to customer service to order by phone. D store offers and supports free delivery service within Ho Chi Minh City for customers if they refer buying products by call.

Cash collection/ Accounts receivable – In Vietnam, payment by cards is not common, but cash. Vietnamese people refer paying by cash for almost transactions of buying something. And at D store, it is no exception, meaning that paying by cash is also the most popular form of payments. However, paying by cards is allowed at D store. In short, customers have two options for their purchases.

Retail process – this process is showed by the below diagram:

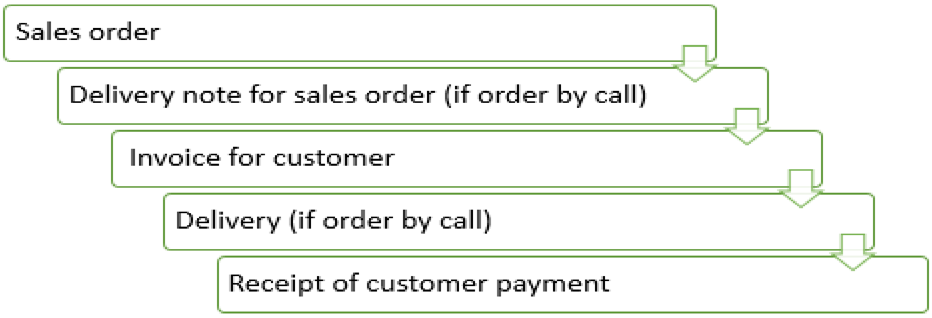


Figure 43: Retail process at D store

6.2.2 Control practices at purchase department

Purchase in D company is the process of buying goods for providing products to D retail store as discussed above. In general, purchasing is believed as the major source of cash outflows of every business and this department is easily vulnerable by fraudulent activities. Hence, management for this department should be in high consideration in place to prevent frauds.

Number of employees – Three persons are allocated to work in this area. All of activities relating to purchase department are under management of purchase manager. According to purchase manager – Mr. Pierre, in this sector there are two main smaller parts, called purchase process and inventory system.

Purchase process

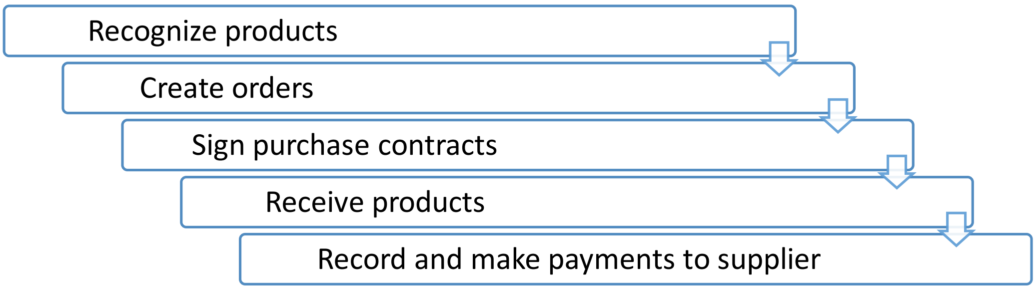


Figure 44: Purchase process at D

The above figure is the original process used in company D when looking for a total new products. This process comprises five stages for making the most valuable purchase for the company. The process starts by the stage of product recognition which is similar to market research of customer needs, then order for needed products is created, signing contracts with supplier should be the next step in this process, after receiving products from suppliers, consequently representative of purchase department will record the purchase into purchase system and make the payments according to invoices to suppliers.

Inventory system

Mr. Pierre shared his opinion that because D retail store is as the second source of revenue, the board of directors did not invest largely for D store as the huge shopping store. The D store is evaluated as a medium-sized store, hence the inventory system consequently is invested in an adequate way which is suitable to the store size.

Generally speaking, inventory system at D store is kind of simple. Employees working for purchase process are also responsible for inventory system, properly it is one of the way to either save salary expenses for the company or take advantages of human resources at D.

6.2.3 Control practices at accounting department

According to Ms. Hong Le – accounting manager at company D, control activities at accounting department is generally called "accounting control**"** at D. Accounting controls are established in order to assure the safeguarding of assets and the reliabilities or transparency of financial reports or records.

Number of employees – In this department, human resources are well-allocated with one accountant, one financial controller and one general manager who is also responsible for activities in accounting department and cash management within the company.

Accounting process – Most of small businesses in Vietnam refer to utilize an accounting system as the combination between manual and computerized approach, even some of them use the manual procedure only for their businesses. At company D, although the size of the enterprise is considered as small-medium sized entity, yet the board of directors initially recognizes the importance of a proper and efficient accounting system for their company, they decided to employee FAST accounting software within accounting department. The accounting process is demonstrated as the following figure:

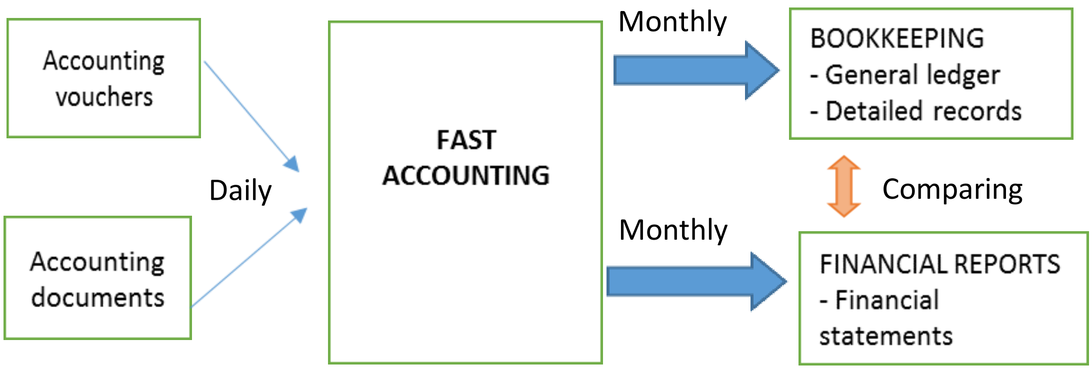


Figure 45: Accounting process at accounting department

In working days, accountant takes information based on the accounting records/documents or summary of accounting vouchers to enter these data into the tables expressed in FAST accounting software. Though FAST software, bookkeeping of the company is well-managed in the proper orders, at the same time, financial reports would come well ahead.

Important accounts in accounting controls – With five years working as accounting managers at company D, Ms. Hong Le truly believes that an appropriate accounting system would contribute effectively to internal control system, and thereby reduce risk of frauds being able to occur within the enterprise in advance. As also stated by Ms. Hong Le, there are four types of accounts that in her opinion play the most important roles in terms of accounting controls as well as internal control activities. They are, respectively cash account, accounts receivable, accounts payable, and payroll account. More specifically, the current practices of these accounts are indicated in the table below:

Table 3. Current practices at four major accounts in accounting system at D

Accounts	Current practices
CASH	1. Cash payments are made when accounting manager signs those payments. 2. Valid cash receipts are received and deposited. 3. Cash receipts are recorded at the correct amount. 4. Cash receipts are recorded at the correct accounting period. 5. Manager usually review the cash flow on sales and purchase procedures.
ACCOUNTS RECEIVABLE	1. Credit and collection policies of the company are formally written 2. Accounts receivable and cash accounts are separately divided. 3. Receivable transactions are recorded at the correct amounts and in the proper periods of time. 4. Accounts receivable are prepared each month and reviewed by the CEO and the COO.
ACCOUNTS PAYABLE	1. Accounting manager and purchase manager usually review and approve the vouchers for payments for purchase department. 2. Other accounts payable (not relating to purchase process) need to be under approval of accounting manager. 3. Payable transactions are recorded at the correct amounts and in the correct periods of time.
PAYROLL	1. Pay rates are authorized by HR manager and approve by the CEO. 2. Payroll functions are done by accounting department, not by HR department, yet the final paychecks are reviewed by HR manager or the CEO. 3. Employees usually are paid for their actual time of working. 4. Only the board of directors and managers have the authorities of accessing payroll records.

7 DISCUSSION

From the findings about internal control's current state and business activities at major departments at D which are collected though questionnaire and interview methods, in this chapter, these findings will be discussed and analyzed based on the author's opinion and knowledge. Furthermore, some suggestion and potential solutions according to the author's ideas will be represented in accordance with each analysis.

The purpose of first discussion is to answer the first research question which is *how internal control system performs at company D in relation to fraud prevention*. Based on the results of the questionnaire, general assessment for internal control system at company D will be investigated to be able to answer the question how effectively internal control system at D performs generally. In addition, the second discussion tends to evaluate controls activities at three main departments at D, and then attempt to find deficiencies at those activities which fraudsters can take advantages at these deficiencies to commit frauds. After understanding the proper deficiencies, some possible solutions built based on COSO framework are represented to help the company enhance its fraud prevention to some extent. This part is also the answer for the second research question in this paper which is *how to improve internal control system for company D to reduce risks of fraud.*

7.1 General assessment for internal control system at D

- **Control environment**

A sound internal control system cannot be built without management of business owners or board of director. Generally speaking about company D, the board of directors does put adequate attentions to internal control system. Through employing FAST ERP program for a small and medium-sized entity as company D, the board of directors indicate that they tend to establish a strict management's philosophy to minimize errors and frauds. Obviously, this concern towards the internal control system has an impact on the conscious of the lower-level employees, and moderately forces them to work properly as their functions as well as compliances the internal policies written earlier.

In addition, management's philosophy also is revealed though the level of integrity and transparence of leaders showing in their work (figure 19). Over 90% of respondents feel the medium and high level of ethical standard from their managers and board of directors. From figure 20, the interaction between boards of directors with employees are plainly high and sufficient with most of meetings conducted weekly and monthly. It means that company D basically has a good basement for designing a sound internal control system.

Organizational structure of company D (see figure 21) is evaluated as a well-designed for communication among departments and proper for the current business development. And, certainly this structure promises an expansion in size in the future. The board of directors believe that this type of structure will ensures the clearness in responsibilities of each person in the company. Thanks to the well-managed organizational structure applied at company D, when asking about the clarity of employees' authority and responsibility division (figure 23), most of respondents believed that they have a clear knowledge about that, yet still there are several employees who are not clear or lightly clear minds of authority division. This would be the first matter in terms of internal control that needs to solve. Another essential aspect belonging to control environment is the company internal regulations or policies. From the figure 25 which focuses on how well employee know about internal regulation, all of respondents said they understand it well.

In short about control environment component at D, required elements such as the transparency and integrity from the board of directors, management's philosophy, the responsibility clarity and last but not least the internal policies are acceptable for a small-sized business as D. Almost elements of control environment according to COSO frameworks are existing and functioning rather effectively at this company.

- **Risk assessment**

Risk assessment for this company was surveyed though two main parts: realizing specific suitable objectives; and identifying and analyzing risks. It seems that risk assessment in business is still an abstract matter with employees and the case company D is not an exception. Although most of employees are aware of their company objective existent and even objective determination by important level (figure 29), there is not much employees are able to have an in depth understanding the company objectives (figure 28).

Identifying and analyzing risk for each potential project or business activities, however, are carried out well in a persistent way at company D. This process indeed needs to be conducted as much as possible in order to minimize the potential losses or errors.

Summary for risk assessment at D is that in general, the company is still conducting essential activities involving risk assessment, yet it is not enough and not be adequate attention. Hence, it should have more risk assessment activities with careful analysis.

- **Control activities**

Assessment for control activities at the company will be analyzed by three elements: performance review (figure 31); physical and data controls (figure 32); segregation of duties (figure 33). Performance review means as comparisons between reports and the real business results. In this element, the company D has regular activities for it since total of 88% respondents believes company D often or even usually conduct performance review to enhance the exactness and authenticity of reports.

About physical and data protection, this element is acceptable when most of employees feel their company control system only being under lightly certain safety. Thus, the company needs more solutions to safeguard assets and data in a confident approach.

A small entity may easily have control deficiencies due to a lack of segregation of duties element. The reason to explain is that employees at those small business perhaps have to perform many different functions, hence it is easy to make their duties overlapped. And when the segregation of duties is not divided visibly, it could be the condition for employees to commit fraud. From figure 34, it can be seen that the division of tasks for human resource at company D is unsatisfied according to the author's opinion. The board of directors and managers should redistribute the task and duties among employees, especially those in accounting and purchase departments.

- **Information and communication**

Information and communication are indispensable conditions to help achieve the different control objectives. The information at the company D is handled mainly on the computer, also sometime associated with the manual approach. Effective information and communication can partly indicated though focused on accounting information systems which mentioned before in the control activities at accounting department session.

As the result seen at figure 35 and figure 36, the information and communication processes within the company in relation to fraud or error are working properly as their functions. 94% of respondents would immediately report to their managers when there is a problem happening but excessing their ability to solve. The connection and interaction between managers and subordinates are maintained in the smooth state as employees are encouraged to inform to the managers about any reasonable suspicion happening around their working environments.

- **Monitoring**

Monitoring is one of the most powerful activities within internal control system. The facts show that a sound internal control system are performed well or not depends much on the physical presence of senior managers. Persistent absences of the owner or managers reduce the effectiveness of control system and simultaneously increase the risk of misstatements and frauds.

Monitoring activities at company D are broken down into two subcategories: ongoing monitoring and separate evaluations. The board of directors, generally speaking put their attentions to ongoing monitoring when their frequency of presence in checking department activities is rather high and intensive (figure 37). Nevertheless, separate evaluations is not good as it should be. There are different opinions on this matter from respondents when asking about the managers' evaluations about employees' performance (figure 38). The board of directors and managers should take the evaluation activities into their account and conduct them more often.

It can be said that, the ongoing monitoring activities are done rather well with the regular presences of the management level. Separate evaluations, however, are still not considerably focused. Thus, if there are abnormal movements occurring to the company, it will be hard to detect and adjust the whole process of business activities in when necessary.

- **Anti-fraud awareness**

The company had been suffered by frauds since nearly half of respondents said they have heard about some fraud of theft occurred within the company before (figure 39).

Nevertheless, when assessing moral values and attitude of the current boards of directors, most of respondents impress the good feelings for it (figure 40). Similarly, about their current colleagues' ethical standard, all of respondents believe that they are working with ethical people (figure 41). Briefly for this part, history of company D suffered with some frauds or theft in the past, but at this time working environment of the company is highly evaluated from its employees when they have faith in their leaders as well as colleagues' ethical standards.

7.2 Solutions for internal control system to reduce risk of frauds at D

From the above general assessment about D's internal control system, the author found that although company D is just a small sized business with nearly fifty employees, the company still had attempts to build a suitable internal control system for the company. In spite of this, the company D still needs to invest more for this system to be able to cope with the risks and frauds, as well as have enough strong potential to achieve the objectives set out.

Based on the previous understanding of current practices of control activities at company D, in this final part, several suggestions for internal control solutions according to the author's knowledge will be presented. There are three main potential control activities are suggested to major function departments of the company: *segregation of duties*; review and *oversight*; and last but not least *authorization*. These powerful control activities are taken according to COSO Internal control framework which is mentioned specifically in the literature review chapter above.

7.2.1 Suggestion for sales department

Table 4. Practices at sales department at company D and suggestions for internal control system to reduce risk of fraud

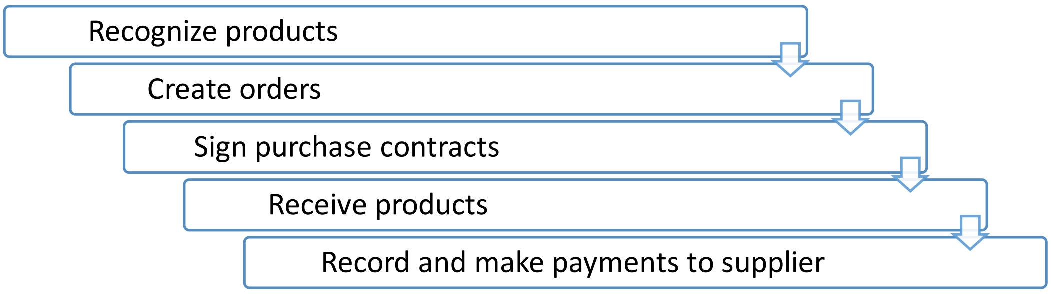
<table>
<tr><th>Practices</th><th>Weaknesses</th><th>Suggestions</th></tr>
<tr><td colspan="3">Sales department</td></tr>
<tr><td>1. Sales employees have the same job descriptions: such as follow the sales management cycle, post the sales data in one common sales data system.</td><td>There is no mutual monitoring among employees, only between employees and managers. If one of them change the amount of transaction with less than the real amount in the system, it is hard to recognize that fraud because the manager has a plenty of data to monitor.</td><td rowspan="4">Segregation of duties: the sales manager must be reassign the job description for each employee.
The common job which described as the sales cycle should be the same for them; however, duties relating sales jobs are recommended to assign differently among those who:
-Approve terms of sales
-Records sales orders
-Invoice customers
-Fill data about accounts receivable
-Receive the payments
-Edit the accounts receivable master file

Review and Oversight:
- The board of directors should conduct review and oversight at this department weekly, or at least monthly.
- Review all outstanding orders, paying special attention to long outstanding orders and the reasons for these orders being long outstanding.

Authorization: All transactions requires signature or electronic approval of a transaction by sales manager.</td></tr>
<tr><td>2. The person signs the contract with customer is also in charge of receiving the payment from them. Usually almost payments are paid by cash, hand to hand.</td><td>This would make a good condition to any employee to commit fraud relating to cash. Sales employee can withdraw a small amount from the payment then edit invoices and receipts according to the amount he wants.</td></tr>
<tr><td>3. Two retail salespersons in the store also have the common jobs, but there is no clarity in their duties. If some cash of store revenue are disappear, both of them will be responsible for that.</td><td>Unclear duties can lead to fraud. One person of them commits fraud, another does not, but consequently both are in charge of that. It is not fair for the person not committing fraud.</td></tr>
<tr><td>4. There is no person at the moment in sales team are mainly in charge of receiving customer complaints relating to payments.</td><td>Complaints from customers for such as wrong amount of money in invoices, or notices for non-payment on account will helps the company find out error or even fraud.</td></tr>
</table>

7.2.2 Suggestion for purchase department

Figure 44 shows purchase process carried out at D with five steps as follow:



From point of view of the author, this process needs to be improved in order to empower purchase management and contribute as a good activity for preventive controls. The figure below is considered as a newly efficient purchase process and fit appropriately with company D business.

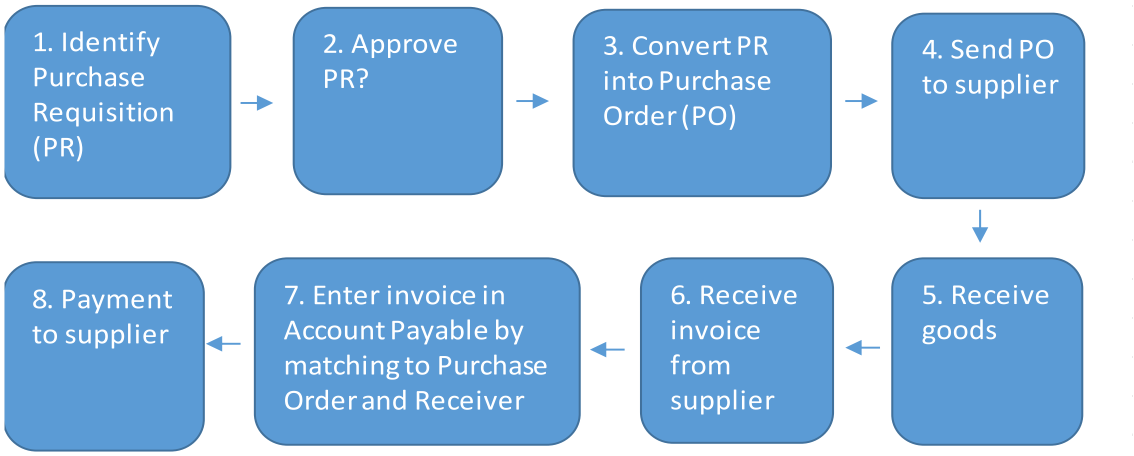


Figure 46: New Purchase and Pay process suggested to company D

Not only about purchase process, there are also some weaknesses existing currently at purchase department of company D. The following table would indicate the practices and suggestions for those weaknesses.

Table 5. Practices at purchase department at company D and suggestions for internal control system to reduce risk of fraud.

Practices	**Weaknesses**	**Suggestions**
Purchase department		
1. The current purchase process at D generally meets requirements of purchase activities but should add more one step to this process which is called *vendor research*.	Lose possibility to purchase products from better vendors.	This useful step helps purchase department find potential vendors for their purchase with higher-quality products and more competitive price.
2. Employees working for purchase process are also responsible for inventory system.	This could make good conditions for employees to commit frauds such as theft or cash-relating frauds.	**Segregation of duties**: the purchase manager must be reassign employees differently for purchase process and inventory system. Assure one person is not responsible for: - Ordering new products - Recording volume at master file - Paying for purchases **Review and oversight**: should be conducted weekly for to review for the correctness. It is important to check that once any asset is purchased, it should be recorded on an asset register with all relevant details. **Authorization**: - New orders must be signed by managers. - Periodic physical counts of the inventory; at least annually, by persons other than the storekeepers.

7.2.3 Suggestions for accounting department

Segregation of duties could be referred as the most effective preventive control activities and in the accounting department, this activity is even more important since financial fraudulent matter is nowadays becoming increasingly serious. If company D could take advantage and apply this preventive activity control into their accounting system, they can prevent in advance a plenty of frauds or misappropriate of cash or asset. The figure below shows the most three essential related work at accounting department which are recording; authorization or approval; and custody of assets. According to "segregation of duties" principle, those related-financial activities must have conducted by different people.

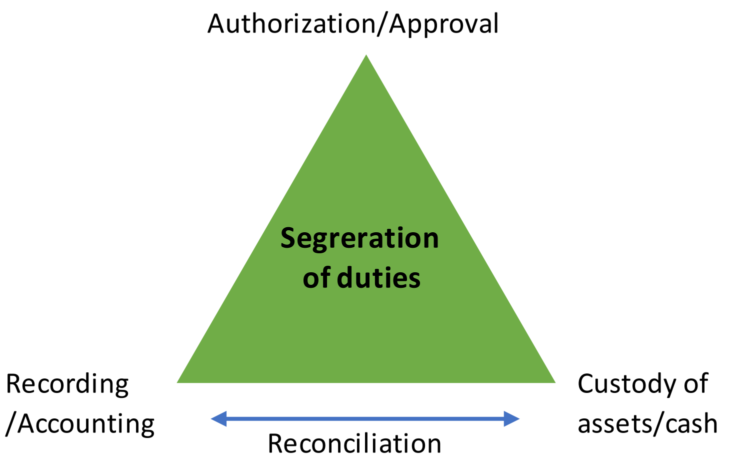


Figure 47: Principle of "segregation of duties" suggested to be conducted at accounting department at D to prevent related-financial frauds.

Several suggestion in correspondent to weaknesses at accounting department will be presented in the following table.

Table 6. Practices at accounting department at company D and suggestions for internal control system to reduce risk of fraud.

Practices	Weaknesses	Suggestions
Accounting department		

1. **Cash account** **-** Cash management and accounting data are managed by only one person – that is accounting manager.	Create good conditions for managers to commit frauds by withdrawing some cash into pocket and then change the accounting data in a logical way to hide.	**Segregation of duties**: one person must not be responsible for two among those works: - Collect cash - Post cash receipts to accounts receivable - Edit the accounts receivable file - Maintain access to cash **Review and oversight**: usually review on cash account. **Authorization**: Every transaction with cash should be documented by correct form and signature of cash manager.
2. **Accounts receivable** - Account receivable is associated strongly to revenue.	Accounts receivable is easily vulnerable by fraud.	**Segregation of duties**: - Collect accounts receivable - Review accounts receivable aging trial balance - Independently investigate accounts receivable differences - Manage the accounts receivable master file **Review and oversight**: Board of director and accounting manage should review reports for collections, billings and write-offs. This activities empower managers to monitor cash flow and also forewarn directors to other frauds such as unofficial write-offs. **Authorization**: The order system should be accurately controlled under the approval of functions by the accounting manager.

8 CONCLUSION

Statistics in associated to frauds is on the rise and the small-sized businesses are the most vulnerable victims of that harm. Hence, those kind of entities should ensure that they have adequate abilities to cope with. A sound internal control system employed for each companies is considered as an appropriate and effective management tool as regards to reduce risk of fraud and enhance their business performance.

Different businesses would have different internal control systems due to the differences in size, organizational structures, as well as industries that the business belongs. The *COSO internal control framework* which mainly used in this research plays as the main guideline to understand internal control system. Yet, the framework just shows itself as general contents of an ideal internal control system to all entities. Hence, choosing a case study with specific information in relation to its internal control brings to the research a practical and more interesting point of views about internal controls. In order to see how COSO framework as well as other internal control relating to risk of fraud are implemented in real life with an unique and specific case, the author considered to take case study of company D into her research. And, to empower the author go further to the research result, questionnaire and interview method are used to get in-depth understanding toward the case study. In short, the author employ the combination of among methods of *literature studies – case study – questionnaire and interviews*. In author's opinion, these combination referred as a good option to support her getting closer to the two research questions of this paper.

Through the study of internal control system in the company D together with various reliable resources in related to the operation of internal control to minimize fraud in business, the author has drawn some general comments and then make recommendations with the purpose of gradually improve the effectiveness of internal control systems of the company. The author believes that two research questions of this study are satisfyingly answered in the chapter 4 and chapter 5. On the whole, the board of director has been carried out a simple internal control system at company D; however, there should be more improvements to be implemented. The author suggests three effective approaches to this company's internal control system which are segregation of duties; review and oversight; authorization. Hopefully, those suggestions could be used in the near future at D.

With knowledge and research capability limitation, the author only propose simple and cost-effectively solutions, yet these solution shall provide efficient impacts to the company internal control. Over time, with the development of the economy as well as of the company, the internal control system will be strengthened and further enhanced to become a coherent system and an indispensable tool in company management.

REFERENCES

Association of Certified Fraud Examiner 2014 (ACFE), "Report to the nations on occupational fraud and abuse", [Online], pp. 31/01/2015. Available from: http://www.acfe.com/rttn/docs/2014-report-to-nations.pdf.

Association of Certified Fraud Examiners (ACFE) May 13, 2014, "Red flags of fraud", [Online], pp. 17 March 2015. Available from: https://chapters.theiia.org/austin/Events/Documents/Ratley%20Red%20Flags%20of%20Fraud_IIA%20Austin.pdf.

Bob L. & Mark J. 2002, "WorldCom: The Accounting Scandal", no. Congressional Research Service.

Chartered Global Management Accountant (CGMA) 2011, "CGMA report: Fraud risk management - A guide to good practice", [Online], pp. 13 February 2015. Available from: http://www.cgma.org/Resources/Reports/DownloadableDocuments/fraudriskmanagement.pdf.

CPA Australia 2008, "Internal controls for small business 2008 Update", [Online], pp. 23 February 2015. Available from: http://www.cpaaustralia.com.au/~/media/corporate/allfiles/document/professional-resources/business/internal-controls-for-small-business.pdf.

Deloitte 2013, "2013 COSO Framework, Deloitte Training ", [Online], pp. 2 January 2015. Available from: https://chapters.theiia.org/Orange%20County/IIA%20OC%20Presentation%20Downloads/COSO%20Training_Deloitte.pdf.

Deloitte 2004, *Antifraud Programs & Controls*. Available: https://www.deloitte.com/assets/Dcom-Shared%20Assets/Documents/us_assur_Antifraud%20whitepaper.pdf [2015, 28 January 2015].

Donald & Pamela 2014, *Business research methods*, 12th edition, McGraw-Hill Irwin, United States.

Edward Chow 2005, "Internal Control and Risk Management - A Basic Framework", [Online], pp. 6th January 2015. Available from: http://www.hkicpa.org.hk/file/media/section4_cpd/Continuing%20Professinoal%20Development%20Programme%20(CPD)/Guide_Eng_August.pdf.

Harrison, H. &.S. 2011, *Financial Accounting. International Financial Reporting Standards*, 8th edition, Pearson Education South Asia, Singapore.

Horngen, H., Oliver 2012, "Internal control and cash" in *Financial and Managerial Accounting*, 3rd edition, Prentice Hall, International, pp. 355.

International Federation of Accountants June 2012, "Evaluating and Improving Internal Control in Organizations", [Online], pp. 15 January 2015. Available from: http://www.ifac.org/sites/default/files/publications/files/Evaluating%20and%20Improving%20Internal%20Control%20in%20Organizations%20-%20updated%207.23.12.pdf.

Jenna Saarni 2012, *Financial Fraud - Importance of an Internal Control System*, Haaga-Helia University of Applied Sciences.

KPMG 2006, "Fraud risk management", [Online], pp. 12 March 2015. Available from: http://www.kpmg.com/CN/en/IssuesAndInsights/ArticlesPublications/Documents/Fraud-Risk-Management-O-200610.pdf.

KPMG 2006, "Guide to preventing workplace fraud", [Online], pp. 17 January 2015. Available from: http://www.chubb.com/businesses/csi/chubb5305.pdf.

Krishna & Paul 2003, "The Fall of Enron", [Online], pp. 28th of Feb, 2015. Available from: http://fisher.osu.edu/~young.53/Healy-Palepu%20Enron.

Mark Saunders & Philip Lewis 2009, *Research methods for business students*, 5th edition, Pearson Education, UK.

Michelle L. Long 2009, "Internal Controls for Small Businesses to Reduce the Risk of Fraud", [Online], pp. 18 March 2015. Available from: http://longforsuccess.com/wordpress/wp-content/uploads/2010/09/Good-Internal-Controls.pdf.

Orrick 2002, "Sarbanes-Oxley Executive Summary", [Online], pp. 20 January 2015. Available from: https://www.google.fi/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0CCEQFjAA&url=http%3A%2F%2Fwww.igc-costarica.org%2Finc%2Fdownload.php%3Ffile%3D19&ei=Le8sVcX3CYHysAH_koDADg&usg=AFQjCNHLNmQ_OnbxZ4C6ZSFkZzTLk81D7Q&sig2=E1gDTpWkGAbrPIqZtNWgXg&bvm=bv.90790515,d.bGg&cad=rja.

Rodney, Mario 2014, *Fraud Prevention and Detection: Warning Signs and the Red Flag System*, CRC Press, Taylor & Francis Group, LLC, USA.

Stephen King "How to Reduce the Risk of Fraud - Internal Controls for Small Business", [Online], pp. 7 March 2015. Available from: http://growthforce.com/presentations/How_to_Reduce_the_Risk_of_Fraud.pdf.

Sue Greener 2008, "Business research methods", CRC Press, Taylor & Francis Group, LLC, USA.

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) 2011, "Internal Control - Integrated Framework, Excusive Summary", [Online], vol. 6, pp. 6 January 2015. Available from: www.coso.orgdocumentscoso_framework_body_v6.pdf.

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) 2009, "Internal Control — Integrated Framework, Guidance on Monitoring Internal Control Systems", [Online], pp. 7 January 2015. Available from: http://www.coso.org/documents/COSO_Guidance_On_Monitoring_Intro_online1_002.pdf.

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) 1994, "Internal control - Integrated Framework", [Online], pp. 14 January 2015.

Available from: http://www.ey.com/Publication/vwLUAssets/COSO_InternalControlFramework_September2012/$FILE/COSO_InternalControlFramework_September2012.pdf.

Tommie & Aaron 2010, *Fraud Auditing and Forensic Accounting,* Fourth edition, John Wiley & Sons, Inc., Canada.

Tracy L. 2008, *Essentials of corporate fraud,* John Wiley & Sons, Inc., Canada.

Uma Sekaran & Roger Bougie 2010, *Research methods for business,* 5th edition, John Wiley and Sons Ltd, United Kingdom.

APPENDICES

Appendix 1

Questionnaire – Internal control for small business to reduce risk of fraud

Hello, I am Tran Loan, student from Arcada University of Applied Sciences, Helsinki, Finland. I am conducting this questionnaire in order to obtain data for my thesis relating to how well of your company's internal control in terms of reducing risk of fraud. I am highly appreciated all your responses with your honest and detail because those data will be used to analyzed in my thesis. This questionnaire take you about 5 minutes to complete. All your answers will be kept completely anonymous and confidential.

Thank you so much

Overview

What is your position in your company? *

How many years have you been working in your company? *

- 0-1 year
- 1-3 years
- 3-5 years
- 5-10 years
- over 10 years

How many people in your department? *

Control environment

1. How well do you know about your company's internal regulations? *

	1	2	3	4	5	
Badly	○	○	○	○	○	Well

2. Which level of clarity does the employees' job descriptions show? *

	1	2	3	4	5	
Unclear	◯	◯	◯	◯	◯	Clear

3. Has professional capacities of each employee been saved in personnel records of the company? *

◯ Yes
◯ No
◯ I do not know

4. Which level of clarity in the division of authorities and responsibilities of each person in the company? *

	1	2	3	4	5	
Unclear	◯	◯	◯	◯	◯	Clear

5. Did the current staff undergoing the process of recruiting and training? *

◯ Yes
◯ No
◯ I do not know

6. Which level are internal information systems protected? *

	1	2	3	4	5	
Low protection	◯	◯	◯	◯	◯	High protection

7. How often does CEO have meeting with departments and employees? *

◯ Every week
◯ Every month
◯ Every quarter
◯ Every year

8. Which level of integrity and transparency do CEO and managers show in their work? *

	1	2	3	4	5	
Low	◯	◯	◯	◯	◯	High

Risk assessment

9. Do you know your company's objectives? *

- Yes
- No
- Do not care

10. Does the company often analyze risks and profits for a potential project or business activity? *

- Yes
- No
- I do not know

11. Does the company determine its objectives' important level? *

- Yes
- No

12. How often does your company update information about market, economics conditions, competitors, or changes in laws, etc? *

	1	2	3	4	5	
Rarely	○	○	○	○	○	Always

Control Activities

13. How often does your company compare between data in reports and real outcomes? *

	1	2	3	4	5	
Rarely	○	○	○	○	○	Always

14. The clarity of division of tasks for each employee in the company? *

	1	2	3	4	5	
Unclear	○	○	○	○	○	Clear

15. How strong of your company's protection towards assets and information? *

	1	2	3	4	5	
Uncertain	○	○	○	○	○	Very certain

16. Does your company's financial reports have enough the completeness, accuracy and validity?
*

	1	2	3	4	5	
Uncertain	○	○	○	○	○	Certain

Information and Communication

17. Does employee immediately report to manager when a problem/error occurs? *

- Yes
- No
- I do not know

18. Are employees encouraged to report any reasonable suspicion to managers or CEO? *

- Yes
- No

19. Are customers' complaints checked again for finding reasons? *

- Yes
- No
- I do not know

20. Does the company periodically assess employees' performances and capacities? *

- Yes
- No
- I do not know

Monitoring

21. How often does the CEO check departments' activities as well as employees' activities? *

	1	2	3	4	5	
Rarely						Always

22. How often does company's managers check and review accounting documents to conform with laws or business regulations? *

	1	2	3	4	5	
Rarely						Always

Your awareness of fraud and theft within the company

23. Has the company had any cases of fraud or theft occurred before? *

- Yes
- No
- I do not know

24. What do you think about leading styles and moral values of the boards of directors? *

	1	2	3	4	5	
Bad						Very good

25. What do you think about your colleagues' moral values and attitudes? *

	1	2	3	4	5	
Bad						Very good

Appendix 2

Interview questions

- **Questions to Sales manager – Ashley Le**

1. How many years have you been working at this company? Describe briefly your job responsibility.
2. How many people in your Sales department?
3. What is the total revenue from sales last year? Please clarify if sales revenue coming from different categories.
4. What are the main drivers of your company's revenue?
5. Are sales revenue usually quite stable every year or it changes dramatically? If the revenue changes dramatically, do you have awareness of that change?
6. Are revenues recorded systematically or manually?
7. Do you have any awareness of types of fraud within your company and especially in your department?
8. Does your sales department have any program or tools that used for preventing or detecting fraud in relation to sales revenue?
9. How do you communicate to your subordinates about ethical behavior regarding to revenue from sales?
10. If someone in the Sales team does a wrong transaction relating to sales revenue by purpose and maybe others employees recognized that transaction, would you be informed and how?
11. Have you ever in pressure from CEO, or higher position for making the revenue look better?
12. What do you think about your CEO/CFO ethical behavior? Do they really have ethical standard to demonstrate to their employees?
13. What are the best controls system that your company should have to prevent frauds in your opinion?

- **Questions to Purchase manager – Pierre**

1. How many years have you been working at this company? Describe briefly your job responsibility.

2. How many people in your Purchasing department?
3. What is annual purchasing volume at your company?
4. Does your department use any ERP system or any program to prevent and detect fraud in relation to purchasing process?
5. Do you have any awareness of types of fraud within your company and especially in your department?
6. How do you communicate to your subordinates about ethical behavior regarding to purchasing?
7. If someone commits a purchase fraud by purpose and others employees recognized that practice, would you be informed and how?
8. What do you think about your CEO/CFO ethical behavior? Do they really indicate their ethical standard to employees?
9. What are the best controls system that your company should have to prevent frauds in your opinion?

- **Questions to accounting manager – Hong Le**

1. How many years have you been working at this company? Could you please describe briefly your role and duty?
2. How many people in your accounting team?
3. Does company use any accounting software? How effective it is in your opinion?
4. Do you have any awareness of types of fraud within your company and especially in your department?
5. What are the current procedures as regards recording transactions as well as creating financial statement process?
6. Does your department has any program or internal controls system or prevention strategy in place to prevent and detect fraudulent transactions in the accounting record system?
7. How do you communicate to your subordinates about ethical behavior regarding to accounting principle and ethical standard in accounting?
8. If someone records a wrong transaction by purpose and others employees suspected that transaction, would you be informed and how?
9. How often do CEO and accounting manager have meeting?

10. Have you ever been requested from CEO, or higher position to make the financial statement look better or record an undocumented transaction?
11. What do you think about your CEO/CFO ethical behavior? Do they really indicate their ethical standard to employees?
12. What are the best controls system that your company should have to prevent frauds in your opinion?

	YES	NO	NOT APPLICABLE
CONTROL ENVIRONMENT			
1. CEO or managers have high integrity			
2. CEO/managers follow existing internal controls, policies and procedures.			
3. Reports generated by accounting software are used by management			
	YES	NO	NOT APPLICABLE
CASH			
1. CEO/manager receives bank and credit card statements directly either by mail or electronically			
2. CEO/Manager signs vendor checks and payroll checks.			
3. CEO/Manager reviews vendor invoices, receiving reports and/or purchase orders when signing checks.			
4. CEO/Manager reviews documentation of payroll calculations when signing checks			
5. CEO/Manager reads monthly balance sheet and income statement and investigates unusual items.			
6. Mail and cash receipts are recorded as received and deposited intact, daily			
7. Mail and cash receipts are counted by two independent persons other than the person recording the receipts.			
8. All journal entries are approved by the CEO/Manager.			
	YES	NO	NOT APPLICABLE
ACCOUNT RECEIVABLE			
1. The CEO/Manager approves all customer requests for credit.			
2. The CEO/Manager receives customer complaints and resolves disputes.			
3. A sales journal is prepared and balanced.			

	YES	NO	NOT APPLICABLE
ACCOUNTS PAYABLE			
1. CEO/Manager approves all vendor payments			
2. CEO/Manager receives and reviews unpaid vendor invoices and statements monthly			
3. Vendor invoices are entered in the purchases journal when received.			
4. Unpaid vendor invoices are maintained in a file separate from paid invoices.			
	YES	NO	NOT APPLICABLE
PAYROLL (SALARY)			
1. CEO/Manager approves all hires and fires			
2. CEO/Manager authorizes wage rates			
3. Payroll checks are distributed by the CEO/manager			
4. CEO/Manager reviews and signs all payroll tax returns and other related documents			
5. Employees time records are maintained and used to calculate paychecks.			
6. Hires, fires, wage rates, time off are approved by department heads or supervisors.			
	YES	NO	NOT APPLICABLE
EXPENSES			
1. When signing checks, CEO/Manager determines account classifications are proper			
2. CEO/Manager investigates any unapproved or unusual disbursements.			
3. CEO/Manager investigates duplicate payments and inadequate documentation.			
4. A descriptive chart of accounts is used			
5. Checks are prepared only when appropriate supporting documents have been received.			
6. The person recording and summarizing transactions cannot sign checks.			