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An Exploratory Study on the Use of Red Flags to Reduce Fraud in the Zimbabwean Corporates

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Abstract
The purpose of this research was to establish the red flags that lead to committing of organizational frauds in Zimbabwe. At both International and local levels there is a general outcry on why there is a rise in the existence of organizational fraud yet this anomaly can be prevented by management. The purpose of this research was to explore the red flags to organizational frauds in corporates. The study explored the types of red flags in an organization and ways in which managers can use them to prevent more frauds. Various authors' views on the subject were consulted. This study employed descriptive research design as its methodology. The reasons behind this choice was that this design allowed for the establishment of factors that impact on a variable and it is one of the methods that can be used also to obtain information concerning a phenomena. The researcher used a number of publications as a method of collecting data. The research concluded that leaders must effectively monitor a red flag to uncover organizational frauds and that there is a link between red flags and committing of organizational fraud.
Key words: red flag, organizational fraud

Nature of fraud

Fraud is defined in the broad sense as an intentional misrepresentation made for personal gain or to damage another individual. It is normally characterized by some form of deliberate deception to facilitate or conceal the misappropriated assets. The fraud that will be discussed in this paper is a nonviolent financial crime perpetrated against business, government or other individual. Fraud is a crime and also a civil law violation.

When a fraud has been committed, the first questions that comes from the mind of the public and investors are "why didn't you see it?" "Where is the Board? "The assumption is that corporate managers should have recognised the warning signs and the loss would have been prevented .It is one of the objectives of the Zimbabwe Agenda for Sustainable Social and Economic Transformation (Zim ASSET) that fraud is minimised or stopped. With the current development in the corporate governance the liability of fraud rests on the board and as such this research can be of importance to them.

The warning signs that corporate managers must always watch out for are the red flags. Research by the Association of Certified Fraud Examiners (ACFE) (examiners, 2006) found that it is a myth that fraud is a big scheme that should have been uncovered sooner and easy to detect. "Fraud starts small and gets bigger and bigger, until something becomes noticeably different or unusual." (Wesley & Bareyi, 2011).

Nature of fraud in the Zimbabwean Environment

Despite having sharp brains locally, regionally and internationally, financial fraud scams are increasing at an alarming rate. Fraud is costly, and it damages the reputation and the credibility of organizations. In Zimbabwe virtually all organizations are aware of the need to establish boards, subcommittees, management team with skills balance, internal and external auditors; but still we are facing an increase in fraud. Recently in Zimbabwe our media were awash with reports of financial scandals in 78 parastatals and 92 local authorities, where millions of dollars are reported to have been lost, and public confidence is fast waning.

In the daily newspapers and national newspapers we read and hear of frauds and scandals committed in organizations. According to Comptroller and auditor General (C & AG)'s audited report of 2011 (Newsday Day Zimbabwe 2013) fraud in the government ministries were on the increase. We read about ministry accountants converting to personal use monies for travel and subsistence and that the government is losing millions of money through tenders and inflated invoice.

A lot of fraud had occurred also in the Zimbabwean banking sector. For example the Trust Bank and the CFX and Century saga and the recent Interfin.According to (Nyanike, Dube, & Mashayange, 2009), the collapse of banks in Zimbabwe was due to creative accounting where banking institutions created two sets of books; one showing a healthy financial status and another one with the a different picture altogether. (RBZ, 2006).The abuse of the computer was reflected by the Merchant Bank criminal case, in which the bank was fleeced of US$5, 5 million by one of the employees.

Findings of the research

Definition of a Red Flag and its importance

Most writers on this subject agree that a red flag is a set of circumstances that are unusual in nature or vary from the normal activity (Thompson & Courtenay , August ,1992).It is a signal /warning signal that something is out of the ordinary and may need to be investigated further. It is important to note that the existence of a red flag does not indicate guiltiness or innocence of the person but that they merely provide possible warning signs of fraud**.** Red flags point out that a possible fraud may be or have been committed. A research by (Wesley & Bareyi, 2011) concluded that ,"a red flag should not be ignored". A number of studies on fraud cases consistently show that red flags were present, but were either not recognized or were recognized but not acted upon by anyone. The conclusion of these researches are that once a red flag has been noted, someone should take action to investigate the situation and determine if a fraud has been/ would be committed to prevent the catastrophe that would befell a company.

Red flags should lead to some kind of appropriate action. However, it must be remembered that sometimes an error is just an error and no fraud would have occurred. There is need for one to be able to recognize the difference between the two and remember that the responsibility for a follow-up investigation of a red flag should be placed in the hands of a measured and responsible person.

According to a survey by ACFE of 2006 (Asssociation of certified fraud Examiners, 2006) occupational fraud can be detected by

• 34.2 percent of frauds were detected through tips,
• 25.4 percent by accident,
• 20.2 percent through internal audits.
• 20.2 percent through red flags

The findings of the above research highlight the importance of red flags in the detection of frauds.

The same research also identified the categories of human beings that are susceptible to committing fraud as;

• 41.2 percent of occupational fraud cases are committed by employees. However, the median loss for fraud committed by managers was $218,000, which is almost three times greater than the loss resulting from an employee scheme.
• Approximately 61 percent of the fraud cases were committed by men. The median loss resulting from fraud by males was $250,000, which is more than twice the median loss attributable to women.
• 87.9 percent of fraud perpetrators have never been charged or convicted of a crime. This supports previous research which has found that those who commit occupational fraud are not career criminals.
• Nearly 40 percent of all fraud cases are committed by two or more individuals. The median loss in these cases is $485,000, which is almost five times greater than the median loss in fraud cases involving one person.
. The median loss attributable to fraud by older employees is greater than that of their younger counterparts. The median loss by employees over the age of 60 was $713,000. However, for employees 25 or younger, the median loss was $25,000.

TYPES OF RED FLAGS

This paper is going to explore the type's red flags in the following categories; employee and management red flag, that managers should watch out for. These findings have been compiled from the experiences of internal auditors who came for the Bcom internal auditing in Masvingo and also from other researchers in the field.

Employee Red Flags

Employee red flags can be noted in the changes in behavior and lifestyle. Writers in this area have noted that employee red flags exist as a result of rationalization, opportunity and pressure. The following are some of the red flags to take note of.

• Employee lifestyle changes: expensive cars, jewelry, homes, clothes
• Significant personal debt and credit problems
• Behavioral changes: these may be an indication of drugs, alcohol, gambling, or just fear of losing the job
• High employee turnover, especially in those areas which are more vulnerable to fraud
• Refusal to take vacation or sick leave
• Lack of segregation of duties in the vulnerable area

Employee changes in Behavior "Red Flags"

The following behavior changes can be "Red Flags" for Embezzlement:

• Borrowing money from co-workers
• Creditors or collectors appearing at the workplace
• Gambling beyond the ability to stand the loss
• Excessive drinking or other personal habits
• Easily annoyed at reasonable questioning
• Providing unreasonable responses to questions

• Refusing vacations or promotions for fear of detection
• Bragging about significant new purchases
• Carrying unusually large sums of money
• Rewriting records under the guise of neatness in presentation

Lifestyle Red flags

According to (Wesley & Bareyi, 2011) this type of fraud is often committed by trusted employees whom management know well, so it is important that managers be on the lookout for employee lifestyle issues that may be "red flags" indicating a fraud risk.

• Some embezzlers are secretive. They don't want to be caught and will "stash" stolen funds and be extremely careful with their spending.

• Other "aspiring" embezzlers want to use, enjoy, share, and show off their fraudulently gained money. Explanations of "new found" wealth may include:

- "My husband/wife just got a great promotion."
- "I have a few little investments that have been doing really, REALLY well."
-"Great Aunt Ethel passed away and I was totally surprised – she left us quite a nice little nest egg."
- "I finally decided to get rid of some property that's been in the family for years."

Lifestyle Problem "red flags"

This type of red flags deals with addictions. For example, someone who is dependent on drugs, alcohol, gambling or other addictions typically experience a slow tightening noose of financial pressures. Desperation fuels monetary needs and, therefore, the need arises to "borrow" funds to ease the financial dilemma. Employees with addiction problems may be tough to spot. Many people with addictions can function at fairly high or normal levels of behavior during work hours.

The following are a few patterns to look for:

- Absenteeism
- Regular ill health or "shaky" appearance
- Easily making and breaking promises and commitments
- Series of creative "explanations"
- High level of self-absorption
- Inconsistent or illogical behavior
- Forgetfulness or memory loss
- Family problems
- Evidence of deceit (small or large)

Red Flags due to financial pressures

For a number of reasons, perhaps beyond their control, employees may find themselves in financially stressful situations due to a variety of factors. These factors include the following:

- Medical bills
- Family responsibilities
- A spouse losing a job
- Divorce
- Debt requirements
- Maintaining a current lifestyle
- Car repairs

Fact: Researchers conclude that the most common reason employees commit fraud has to do with motivation – the more dissatisfied the employee, the more likely he or she will engage in criminal behavior.

Management Red Flags

Management fraud can be found wherever managers have the opportunity and the need to better their purse, their status, or their ego through deception. Deception by managers –people of position and trust is not often talked about. It is more often concealed than revealed. It is usually covered up by its victims to avoid adverse effects of publicity. The opportunity usual lies in their fiduciary position-positions of trust where they command belief and respect and they are rarely questioned.

Investigation consultants have identified a set of symptoms that are usually reliable indicators of an improper condition. The symptom is but a surface lesion. The cancerous condition lies below it, but the lesions have to be recognized for what they imply.

Below are some these indicators as identified by researchers in the area;

• Reluctance to provide information to auditors
• Managers engage in frequent disputes with auditors
• Management decisions are dominated by an individual or small group
• Managers display significant disrespect for regulatory bodies

• There is a weak internal control environment
• Accounting personnel are lax or inexperienced in their duties
• Decentralization without adequate monitoring
• Excessive number of checking accounts
• Frequent changes in banking accounts
• Frequent changes in external auditors
• Company assets sold under market value
• Significant downsizing in a healthy market
• Continuous rollover of loans
.Excessive number of year end transactions
• High employee turnover rate
• Unexpected overdrafts or declines in cash balances
• Refusal by company or division to use serial numbered documents (receipts)
• Compensation program that is out of proportion
• Any financial transaction that doesn't make sense - either common or business
• Service Contracts result in no product
• Photocopied or missing documents

Steps to be taken after identifying red flags

Managers or any other investigators must not ignore the red flags.The following are some steps that can be taken;
• Take action to follow up the red flag
• Carry out financial analysis
• Comparing actual to expected results
• Plug the loop holes before asking questions

Reporting Fraud

• Allow anonymous type of reporting from employee to management
• Use whistles blowing techniques
• Report the matter to the police only with correct facts
• Use special investigation to establish the correct facts

Recommendation and conclusions

Red flags are warnings that something could be or is wrong. It is imperative that auditors, employees, and management need to be aware of red flags in order to monitor the situation and then take corrective action as needed. Employees who notice that red flags are ignored may mistakenly believe that it is okay to game the system or that they won't get caught. Managers and auditors must remember that a little fraud soon becomes a large one if left to grow and therefore an immediate action must be taken.

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