

Fraud Risk Management And Sustainability Of SMEs In Nigeria

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Abstract: Fraud risk is one of the business risks that Small and Medium Scale Enterprises (SMEs) face in their operational activities. This study was carried out to examine the relationship between SMEs sustainability and the application of fraud risk management mechanisms. The study used a survey research design. The population consists of all SMEs in Nigeria while the sample is made up of 90 small businesses operating in Delta State. Data for the study was obtained through a self-developed questionnaire measuring some variables on fraud risk management mechanisms, financial performance and sustainability of the sampled SMEs. A multiple regression analysis was conducted to test the model established for the study. The study finds that internal control activities and internal audit functions have a significant positive relationship with sustainability of SMEs. The study also finds a weak but positive relationship between management experience and sustainability of SMEs and concludes that implementation of a sound fraud risk management system is necessary to enhance long term survival of the firms. The study therefore recommends that SMEs should endeavor to keep a proper accounting system and an effective internal control mechanism in place to safeguard against losses and corporate failures.

Keywords: Fraud Risk Management, Sustainability, Small and Medium Scale Enterprises.

I. INTRODUCTION

Fraud risk management as a mechanism comprises the plan of an organization and all the co-ordinate methods and measures adopted within a business to safeguard its assets check the accuracy and reliability of its accounting data; prorate operational efficiency and adherence to prescribed managerial policies. Thus it helps an organization to prevent frauds, errors, minimize wastage, strengthen the custody of assets and provides assurance to the management on the dependability of accounting data; eliminates unnecessary suspicion and helps in maintenance of adequate and reliable accounting records.

The unique role that Small and Medium Scale Enterprises (SMEs) play in the development of an economy calls for careful consideration in the design and implementation of effective fraud risk management system. Private sector involvement and grooming the Small and Medium Scale Enterprises (SMEs) have become necessary in the redirection of the Nigerian economy towards self-sufficiency. Nigeria's

economy is in a coma, thereby necessitating a shift of focus from the grandiose capital intensive, large-scale industrial projects to small/medium scale enterprises with immense potentials for developing domestic capacity for rapid substantial industrial development. A number of studies (Olatunji, 2013; Osamwonyi & Tafamel, 2010; Ojo, 2006) have shown that for the economy to meet expectations as one of the twenty largest economies in the world by the year 2020, industrialization and promotion of small scale business hold the key. Iopev and Kwanum (2012) and Arowomole and Oyedokun (2006) all agree that the strength of great nations derives from the small and medium scale enterprises who work tirelessly as backbones to the industrial giants.

According to an OECD report, SMEs account for over 95% of firms, 60-70% of employment and 55% of Gross Domestic Products (GDP) in OECD countries. It is also estimated that in developing countries, SMEs represents more than 90% of all firms and such firms contribute significantly to national income (OECD, 2016). SMEs located in both the rural and urban areas accounts for almost ninety percent of all

business organization in developing countries, providing employment and income redistribution among the citizenry. Nigeria, considered as the largest economy in Africa has about 70% of industrial employment by SMEs (Adebusuyi, 1997). According to Adeloye (2012), Nigeria has an estimated population of seventeen million SMEs, representing over 80% of the total number of firms in Nigeria and employ over 31 million Nigerians or about 75% of the total workforce.

However, SMEs in developing countries like Nigeria are faced with myriad of problems which affect their sustainability and performance. Constraints such as lack of finance, insecurity, poor infrastructure, government unfavourable fiscal policy and policy inconsistency have well been researched in prior studies (Siwangaza, Smit, Bruwer & Ukpere, 2014; Kanu, 2015; Gbegi & Adebisi, 2015). However, one factor that is rarely examined as having a possible impact on failure or sustainability of SMEs is fraud risk.

Small and Medium Scale Enterprises face big challenges when it comes to managing fraud risks. According to Siwangaza, Smit, Bruwer and Ukpere (2014), SMEs are much more vulnerable proportionally to fraud by managers and employees, and much less able to absorb these losses than large corporations. Financial strain, rapid growth, and a lack of resources and expertise create ample opportunity for fraudulent employees to take advantage of small businesses. The Association of Certified Fraud Examiners (ACFE) of the United States (1998) reported that small businesses were the most vulnerable to fraud and abuse by employees. Njaramba and Ngugi (2014) stated that, the greatest financial impact of fraud can occur in a small-business environment. Njaramba and Ngugi posit that a loss of 6% of revenues is significant for any company, regardless of its size, but a small enterprise whose margins are thin and reserves nonexistent will go out of business. They maintain that even if an SME survives the fiscal loss, its business continuity can be in jeopardy and it may no longer be able to function as an independent entity. Kanu (2015) viewed fraud as a business risk in just the same way as an organisation faces the risk of a customer becoming insolvent and unable to pay their debts. The absence of an established policy means no position has been taken by the business. Therefore, the company has to come out with fraud prevention policy, for the business to communicate to its employees what is expected of them in terms of preventing, deterring and detecting fraud. Such a policy is essential as fraud prevention must always be proactive.

Campbell and Hartcher (2003) assert that SMEs are reputed to have weak internal controls procedures. SMEs view the cost of installation and implementation of an adequate system of internal controls as a costly exercise. Tuner (2007) further supported this latter view by stating that a major limitation of implementing proper internal controls is the cost inherent in the approach. This approach entails that owners of SMEs weigh the costs of implementing a system of internal controls against the potential benefits that can be derived from having it implemented. Inevitably this approach, more often than not, will result in inadequate internal controls to be implemented and, consequently, creating a business environment that is susceptible to unwarranted fraud risks.

Suffice to state however, that if fraud risks continue to surface in SMEs, corporate performance of the SMEs may be adversely affected thereby throwing the overall sustainability of the SMEs into jeopardy. Wai (2008) stresses that fraud risk management mechanisms establish an internal processes with the positive goal of helping a business meet its set objectives.

Fraud risk management systems are an integral part of any organization's financial and business policies and procedures. Fraud control measures consist of all the techniques taken by the organization for the purpose of, protecting its resources against waste, fraud and inefficiency; ensuring accuracy and reliability of accounting and operating data; ensuring compliance with the policies of the organization; evaluating the level of performance in all organizational units of the organization (Enofe, Mgbame, Otuya & Ovie, 2013).

Further, the internal control as a fraud risk management technique is a means and a way of directing, monitoring and measuring the SMEs resources. It plays an important role in preventing and detecting fraud and protecting the physical and intangible resources as well as leading to high efficiency of the business operation. This study therefore seeks to examine the effect of fraud risk management on sustainability of small businesses in Nigeria with emphasis on SMEs in Delta State.

II. STATEMENT OF PROBLEMS

Small and Medium Sized Enterprises play a significant role in the economic development of any nation. Regrettably, in spite of their importance, there is still a large number of SMEs that perform poorly or fail due to incidence of fraud. Except for legal requirements, small and medium scale enterprises hardly give any serious consideration to the issue of implementing a sound accounting procedure and internal control process, yet the lack and ineffectiveness of fraud risk management have been responsible for untimely collapse of a host of them (Mukaila & Adeyemi, 2011; Wai, 2008).

A major factor for the choice of SMEs for this study is that lack of fraud risk management tend to be more problematic for their size since larger firms by their nature and scale of operation are statutorily required to install and implement a sound internal control system to check, prevent, deter fraudulent activities.

Further motivation for the study is that fraud risk management in SMEs in Nigeria has got very little attention. Most previous researches tend to view sustainability of SMEs from a larger economic perspective without considering the effect of fraud on going concern of small businesses. This study also makes a clear departure from previous studies by being one of the first with emphasis on the Niger Delta region of Nigeria which has suffered from youth restiveness and unemployment. It is hoped that the paper could help to identify the level of SMEs owners' awareness on fraud risk management and to assess how its control mechanisms can affect the performance and sustainability small businesses in the area.

OBJECTIVES OF THE STUDY

The broad objective of the study is to examine and describe the effectiveness of fraud control mechanisms on sustainability of Small and Medium Enterprises in Nigeria with particular emphasis on Delta State. Specifically, the study seeks to:

- ✓ assess the extent to which internal control activities affects SMEs sustainability;
- ✓ examine the impact of internal audit functions on sustainability of SMEs;
- ✓ investigate the relationship between managerial experience and sustainability of SMEs

RESEARCH HYPOTHESIS

The following hypotheses are proposed for the study:

- ✓ Internal Control activities have no significant statistical effect on the sustainability of small and medium scale enterprises in Nigeria.
- ✓ There is no significant statistical relationship between internal audit functions and sustainability of SMEs.
- ✓ There is no significant statistical effect of managerial experience and SMEs sustainability

III. LITERATURE REVIEW AND CONCEPTUAL CLARIFICATIONS

FRAUD RISK MANAGEMENT

Fraud is a major cause of loss and failure to small and micro businesses and creates morale problems in the work place. Gbegi and Adebisi (2015) define fraud as all multifarious means which human ingenuity can devise and which are resorted to by one individual to get advantage over another by false suggestions or suppressions of the truth. It includes all surprises, tricks, cunning or dissembling, and any unfair way which another is cheated. Fraud essentially involves using deception to dishonestly make a personal gain for oneself and/or create a loss for another. Risk on the other hand is a combination of probability that some (dangerous) event will occur and the consequences of it if it actually occurs (KPMG, 2007). Ernst & Young (2003), views the term fraud risk as one component of operational risk which focuses on the risks associated with frauds or events in transaction processing or other business operations. Risks such as false accounting or the theft of cash or assets need to be considered for each part of an organisation's business. Fraud risks can occur in certain area and operations process of the business, for example, cash payments, cash receipts, sales, purchasing, expenses, inventory, payroll, fixed assets and loans.

Consequently, fraud risk management is a process which is developed by relevant stakeholders, within a business, with the main intention to provide reasonable assurance regarding the achievement of three objectives, namely the safeguarding of assets, the integrity and reliability of financial and operational information and compliance with rules and regulations (FEE Brussels, 2005; Enofe, Mgbame, Otuya & Ovie, 2013).

Fraud risks are serious challenges to modern small scale organizations hence need to be managed, controlled and monitored. The Association of Certified Fraud Examination (ACFE) identifies three main categories of fraud that affects organisations; the first of these is asset misappropriations, which involves the theft or misuse of an organizations asset. Examples include theft of inventory or cash, false invoicing, accounts receivable fraud and payroll fraud. The second category of fraud is fraudulent financial statements which are the most costly while the third fraud categories and most common is corruption occurring in twenty seven percent of all fraud cases (AICPA, 2009).

According to COSO (2011), to have internal control processes, there need to be five inter-related elements evident, namely control environment; risk assessment; control activities; information and communication; and monitoring. These five control elements are reported by COSO to be derived from the manner in which management operates within their respective businesses, in a general sense, and are integrated within generic management processes. These elements collectively help any organisation to accomplish its fraud risk management objectives and, as such, each element should be present in organisations to have some sort of assurance of effective internal controls.

SMALL AND MEDIUM SCALE ENTERPRISES

Authors have not reached a consensus on the definition of SMEs. The concept of SMEs does not have a single definition because it changes with time, and it is viewed differently by organizations, institutions and geographical locations. What however has been deduced from the various definitions is that the authors have reduced the criteria to be considered for SMEs definition into two perspectives which are the theoretical and operational definitions (Kanu, 2015; Yusuf & Dansu, 2013). According to Henschel (2009), a theoretical definition of SMEs considers qualitative criteria such as autonomy, personal comprehensibility as well as the financial and personal engagement of at least the owner. Altman, Sabato, and Wilson, (2008) further posit that an operational definitions of SMEs look at quantitative criteria like annual turnover, number of employees and capital outlay.

The major characteristic of SMEs in Nigeria is that they serve as a linkage or relates to ownership base or structure, which mainly revolves around one man or family. Hence, the preponderance of the SMEs is a one-man business (sole proprietorships) or more than one-man business (partnerships). It is observed that even where the registration status is that of a limited liability company, the real fact of ownership in SMEs is that of a one-man, family or partnership business (Yusuf & Dansu, 2013). The study adopts the definition of SMEs by The Central Bank of Nigeria, in its 2005 guideline on Small and Medium Enterprise Investment Scheme (SMEIS), which described SME as any enterprise with a maximum asset base of 200million naira (excluding land and working capital) with no lower or upper limit of staff (CBN, 2005).

SUSTAINABILITY

The long term objective of every business (SMEs inclusive) extends beyond profit-making. Growth, expansion and sustainability constitute key strategic objectives of SMEs. However, most SMEs in developing countries have had a short-lived life span. Idemobi (2012) revealed that over 70% of SMEs die within five years of establishment. This means that less than 30% of SMEs can survive various business challenges. Sustainability and long term survival is often considered as a possibility for bigger corporations than SMEs because of variations in size and ability to overcome challenges in the business environment (Turner, 2007).

Crals and Vereek (2004) argue that for SMEs to achieve sustainability, they must recognize and extend fair treatment to the three P's of People, Planet and Profit. Firstly, the aspect of "People" looks at how SMEs handle social and ethical issues. Crals and Vereek opine that key issues such as employees' welfare, protection of human rights, non-indulgence in fraud and corruption, gender relationship and discrimination on the work floor, employees' participation in management and profits are essential considerations to the survival of the SMEs.

The second in the 3Ps represents the "Planet" or environment in which the business operates and is used here to consider the effect and remedy of operational activities on the natural resources. It is therefore imperative that SMEs show adequate care towards the natural environment. Finally, 'Profit' the third aspect does not relate directly to the financial results of an enterprise. It also considers the use and allocation of value added for employment, investments in machines and infrastructure (Crals & Vereek, 2004). It can therefore be seen that the 3p's of sustainability also constitute a major sources of business risks faced by SMEs. Consequently, a painstaking effort in recognizing and handling of these three aspects would not only mean movement towards sustainability but also attempt to address the fraud risk which is part of the business risks that hamper the performance and sustainability of SMEs.

IV. METHODOLOGY

This study adopts a survey research design to assess the level of fraud risk management mechanism on SMEs in Nigeria with particular emphasis on Delta State. The population of the study consists of all SMEs in Delta State. The population covered virtually all forms business organizations such as Sole Proprietorship, Partnership, Private Limited companies which satisfy the SME criteria. There are about 904 registered micro businesses in Delta State (Delta State Business Directory, 2017). Using data from Delta State Business Directory 2017, a proportionate sample size of approximate 90 respondents which is 10% of the population was selected using a stratified random sampling technique from the identified sample. Kothari and Garg (2014) indicates that a sample size of 10% of a target population is considered large enough so long as it allows for reliable data analysis and allows testing for significance of differences between estimates. The respondents in this study were the owners/managers of the targeted SMEs. The study made use

of primary data. To achieve this, a self-developed questionnaire was designed. The questionnaire is divided into two sections. Section A seeks to obtain information on details of companies while Section B consists of items checklist/variables measuring fraud risk management mechanisms, financial performance and sustainability of the sampled SMEs.

Multiple Regression analysis was conducted to establish the form of relationship between dependent variable and the independent variables. To test the hypotheses developed, a liner and multivariate regression model which expresses the SMEs sustainability as a function of fraud risk management mechanism is stated in functional form as follows:

$$SMESUS = F(INTCT, INTAUD, MGTEXP)$$

This can be written in explicit econometric form as:

$$SMESUS_i = \beta_0 + \beta_1 INCCT_i + \beta_2 INTAUD_i + \beta_3 MGTEXP_i + e_i$$

Where:

SMESUS= SMEs Sustainability measured in term of growth rate as a change in turnover in the past two years; INTCT, INTAUD, MGTEXP represent Internal Control Activities, Internal Audit functions and Managerial expertise respectively measured in terms of responses on the checklist developed in the questionnaire. e = Stochastic or disturbance term while i represents the SMEs. β_0 = Constant or Intercept. β_{1-3} = Coefficients to be estimated or the Coefficients of slope parameters.

V. DATA PRESENTATION AND ANALYSIS

90 Small and Medium Sized Enterprises (SMEs) were surveyed. Of the sampled firms, 51% are limited liability companies, 30% sole proprietorship, 12% partnership and 7% are cooperative society form of business organisations. Analysis of age of firms shows that 17% of the SMEs have been in operation for less than 5 years; 28% (6-10 years); 42% (11-20 years) and 13% (over 21 years). 47% of the sampled SMEs have a qualified accountant, 23% have an internal auditor and only 13% have both accountant and internal auditor. Further analysis of the questionnaires revealed that 67% of the firms have had incidence of fraud in the past. 54% of fraud incidence are employees absconding with sales revenue, 21% inflation of purchases receipts, 9% falsification of bank deposits while 16% fall into other fraudulent activities.

VI. ANALYSIS OF FINDINGS

The results of findings through testing the various hypotheses formulated using the multiple regression analysis are present below:

HYPOTHESIS ONE: INTERNAL CONTROL ACTIVITIES AND SMES SUSTAINABILITY

In order to provide answer to the question of the impact of Internal Control Activities on SMEs sustainability in hypothesis one, SMEs growth rate and internal control activities (using Authorisation Procedures, Segregation of

Duties, Accounts Reconciliation and Access Control) are analyzed:

Model	Sum of Squares	df	Mean ²	F	Sig	R	R ²	Adjusted R ²	SEE
Regression	28938.074	4	7234.52	68.4	.000	.873	.763	.752	10.28
Residual	8989.376	85	105.76	0	(a)	(a)			
Total	37927.451	89							

a Predictors: (Constant), Access Control, Authorisation Controls, Acct Reconciliation, Seg of Duties

b Dependent Variable: Sales Growth

Table 1: Regression Statistics for Int. Control Activities and Growth

The summarized regression results shows that the multiple regression model is highly significant. The coefficient of determination or R² is .763. This shows that the model is able to explain about 76 percent of the variations in the dependent variable of the model is explained by the variations in the independent variables. Also, the f-ratio of 68.40 shows that the predictor variables are very significantly related with the response variables. It provides a statistic for testing the hypothesis that (there is a significant relationship between the response and predictor variables), against the null hypothesis that (there is no significant relationship between internal control activities and growth of SMEs).

HYPOTHESIS TWO: INTERNAL AUDIT FUNCTIONS AND SMES SUSTAINABILITY

To test hypothesis two, internal audit functions variables such as Accounting System, Presence of Internal Auditor, Performance Review and Incidence of Fraud are used as independent variable against SMEs growth as dependent variable.

Model	Sum of Squares	df	Mean ²	F	Sig	R	R ²	Adjusted R ²	SEE
Regression	20993.621	4	5248.38	26.34	.000	.744	.5	.533	14.11
Residual	16933.930	85	199.22		(a)	(a)			
Total	37927.451	89							

a Predictors: (Constant), Performance Review, Acct system, Internal Auditor, Past Fraud Incidence

b Dependent Variable: Sales Growth.

Table 2: Regression Statistics for Int. Aud. Functions and Growth

As shown in regression table, P-Value = 0.000 < 0.05 indicated that there is enough evidence to support the alternative hypotheses, that there is a significant linear relationship between SMEs growth and fraud risk management mechanisms as performance review, presence of internal auditor, a good accounting system and past incidence of fraud. The F-ratio is 26.34.

HYPOTHESIS THREE: MANAGEMENT COMPETENCE AND SMES SUSTAINABILITY

To test this hypothesis, variables such as Directors' Training, Education, Experience, Management meetings, business plan and company age were regressed against the growth rate of the SMEs.

Model	Sum of Squares	df	Mean ²	F	Sig	R	R ²	Adjusted R ²	SEE
Regression	13871.457	4	2311.90	7.9	.000	.605	.36	.320	17.02
Residual	24055.994	85	289.83	7	(a)	(a)			
Total	37927.451	89							

a Predictors: (Constant), Period of Operations, Staff Training, Directors Education, Directors Experience, Business Policies and Procedures, Management Meetings.

b Dependent Variable: Sales Growth.

Table 3: Regression Statistics for Management Competence and Growth

The summarized regression results in table 03 show that the multiple regression model is weakly significant. The coefficient of determination or R² is .366. This shows that the model is able to explain about 36 percent of the variations of the growth. Further, the Analysis of Variance (ANOVA) provides a statistic for testing the hypothesis that there is a weak positive relationship between growth of SMEs and the predictor variables (Period of Operations, Staff Training, Directors Education, Directors Experience, Business Policies and Procedures and Management Meetings). Correlation exist between the response and predictor variables if P-value < 0.05. As shown in table, P-Value = 0.000 < 0.05 indicated that there is enough evidence to support the alternative hypotheses, that there is a linear relationship (weak) between SMEs growth and management experience.

VII. DISCUSSION OF FINDINGS

The study was undertaken to examine the effect of fraud risk management on sustainability of SMEs in Nigeria. Based on the data obtained from the survey results of the sampled firms, the study summarizes the findings as stated below:

- ✓ That implementation of fraud risk management mechanism still very low in Nigeria's small and medium sized firms. Several of the SMEs visited do not have a standard accounting system in place with a poor internal control framework. In most cases, the owner serves as the manager and accountant.
- ✓ It was also discovered that fraud incidence such as cash theft, falsification of sales figure, cost price inflation and sales attendants absconding with accumulated cash sales are still rampant due to weak checks and balances in the control process.
- ✓ Based on the study hypothesis, the study finds an empirical evidence to support the claim that is a significant relationship between internal control activities and growth of SMEs. This meets our apriori expectation and implies that as SMEs design and implement a sound fraud risk management mechanism, sustainability and growth will be maintained. This finding is consistent with previous studies such as Olatunji (2013), Yusuf and Dansu (2013) and Siwangaza, Smit, Bruwer and Ukpere (2014).
- ✓ Findings of the study also reveal a significant linear relationship between SMEs growth and internal audit functions. The implication is that small businesses that engage the services of qualified internal auditors have better growth and sustainability prospects. This finding meets our apriori expectation and conforms to findings by Kanu (2015).
- ✓ Empirical analyses also reveal a weak positive relationship between growth of SMEs and management experience. It implies that although there is a positive linear relationship between management competence and growth, the level of education and experience of SMEs owners has a little to do in terms of sustainability of the

business. This result did not meet our apriori expectation. However, the result conforms with other studies (Njaramba & Ngugi, 2014; Gbegi & Adebisi, 2015) which shows that managerial expertise has a positive relationship with firms' growth.

VIII. CONCLUSION AND RECOMMENDATION

This study was carried out to examine the relationship between growth of the Nigerian's small and medium scale enterprises and the application of fraud risk management mechanisms. The uniqueness of our analysis comes from its disaggregation of investigative variables into a number of alternatives based on data analysis from the survey carried out. We have analyzed some simple descriptive statistics and we have used a regression model to verify the level of implementation of fraud risk management system and its impact on sustainability of SMEs in Nigeria.

The study showed that internal control activities and internal audit functions have a significant positive relationship with sustainability of SMEs. The study also found a weak but positive relationship between management experience and sustainability of SMEs and concludes that implementation of a sound fraud risk management system is necessary to enhance long term survival of the firm. The study therefore recommends that SME should endeavor to keep a good accounting recording system and an effective internal control system in place to safeguard against losses and corporate failures.

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