

# Chapter 14

## Internal Control System in Cooperative Society

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### ABSTRACT

*The increasing number of recent fraud cases involving the board of directors and top management in cooperative societies has raised concerns about the effectiveness of internal control systems (ICS) in these organizations. This chapter aims to examine the relationship between the effectiveness of the ICS and the likelihood of fraud occurrence by focusing on the control environment, risk assessment, and monitoring activities of cooperative societies in Malaysia. The results showed that the effectiveness of the control environment, risk assessment, and monitoring had no significant relationship with the likelihood of fraud occurrence in these organizations. However, this does not necessarily mean that the fraud risk is not an emerging issue. The study proposes that the internal auditors and audit committee oversee a pro-active fraud prevention check-up, as suggested by the Association of Certified Fraud Examiners (ACFE), which is to be implemented in co-operative societies to assess how vulnerable the organizations are to fraud.*

### INTRODUCTION

Fraud negatively impacts organisations in many ways including financial, reputation, psychological and social implications (IPPF, 2009). Fraud can be committed by an employee at any level within an organisation, as well as by those outside the organisation (IPPF 2009, p.2) indicating the importance of a good internal control system. The Committee of Sponsoring Organizations of the Treadway Commission (COSO)'s Internal Control – Integrated Framework (2013) describes an internal control as a process

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### ***Internal Control System in Cooperative Society***

consisting of ongoing tasks and activities that are effected by people at every level of an organisation. As such no industry or size of company is immune from fraud (Kapardis & Zopiatis, 2010) including the co-operative societies.

Fraud in cooperative societies is not new within developing countries context. In India for example, Adarsh Credit Co-operative ran Ponzi schemes promising a double in the deposits in six years and shifted most of the money deposited by the victims to shell companies being run by the relatives and friends of Mukesh Modi, the Chairman and the main promoter of Adarsh Credit (“Adarsh Credit Co-op”, 2018). In another case, Sharmahan Multipurpose Cooperative Society had cheated customers in relation to their deposits and chit fund memberships. In Nigeria, the Niger State Government received reports of fraudulent activities going on in some of the Nigeria Union of Teachers (NUT). In Pakistan, Karimabad Ismailia Multipurpose Cooperative Society was involved in misappropriation of society funds, security deposits and transfer fees (“NAB arrests five”, 2018). Close to home, two ex-employees duped the Singapore’s oldest co-operative, Singapore Statutory Boards Employees; Co-operative Thrift and Loan Society, of S\$5.1 million of members’ savings by using names of phantom members to apply for a termination of their membership, withdrawal or loan (“Two charged”, 2018). However, research on co-operative societies is limited. Previous scholarly academic research has focused on the perceived benefits and costs of implementing the framework (e.g. Beneish, Billings, & Hodder, 2008; DeFond & Francis, 2005), discussion and evaluation of the framework (e.g. Lawson, Muriel, & Sanders, 2017; Proviti, 2013), studies on the impact of the framework (Cohen, Krishnamoorthy, & Wright, 2010; Klamm & Watson, 2009), and on firm’s existing controls (e.g. Janvrin, Payne, Byrnes, Schneider, & Curtis, 2012). Empirical research that provides similar evidence in NPO, especially the co-operative societies, is lacking. The pressing need is evidenced by the increasing fraud-related cases involving weaknesses in ICS in Malaysian cooperatives (see Table 1).

The British colonial administration introduced the concept of co-operative to Malaya (now Malaysia) for peasants, farmers and fisherman in 1922 (Fredericks, 1986) as part of its initiatives for poverty eradication in the rural areas. The co-operatives looked after the welfare of the members’ children, education, housing ownership, employment and entrepreneurship opportunities. The mission was extended further to include better governance and management through the government’s National Co-operative Policy, first launched in 2002. The Co-operative Societies (Amendment) Act, 2007 (hereafter the Act) defines a co-operative society as an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly owned and democratically con-

*Table 1. Selected cases involving internal control 2010–2013*

Cases/Year	2013	2012	2011	2010
Abuse of Authorisation System	9	9	10	7
Assets misappropriation		3	3	3
Inappropriate use of documents and records	1	2		1
False (billing) claim	1			
Unjustified expenses				
Misuse of funds	1	1		
Total	12	15	13	11

Source: (Investigation and Enforcement Unit of Malaysia Co-operative Society Commission, 2014)

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