

Fundamentals of financial fraud.

Peter N. Munachewa

Managing Consultant

Betabiz Risk Consulting





Forensic Accounting and Audits ?

- Forensic Accounting/ auditing is one of the latest means to facilitate the prevention, detection, investigation and successful prosecution of economic crime, **in particular fraud**.
- It is a specialist area that involves application of law, accounting, criminology, auditing and investigative skills.
- The term ~~forensic~~ means suitable to courts of justice or for public discussion and debate.
- Forensic accounting/ auditing provides an investigation methodology and accounting analysis that is suitable to the court/tribunal which will form the basis for discussion, debate and ultimately dispute resolution



What is fraud?

- **Fraud may simply be defined as a deceitful act by a person for the purpose of making money.**
- **Black's Law Dictionary defines fraud as:**
"... all multifarious means which human ingenuity can devise, and which are resorted to by one individual to get an advantage over another by false suggestions or suppression of the truth. It includes all surprise, trick, cunning or dissembling, and any unfair way by which another is cheated."
- **There does not appear to be an offence known as 'fraud' per se in the Kenya law.**
- **A crime must be predicated by an act of Parliament so as to be subjected to control by the criminal justice system**
- **In the Kenyan context, the nearest we can come to defining fraud in law is under sec. 268 of Penal Code Chapter 63 Laws of Kenya.**
(1) – a person who fraudulently and without claim of right takes anything capable of being stolen, or fraudulently converts to the use of any person , other than the general or special owner thereof , any property is said to steal that thing or property.



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Fraud impact to business

- Organisations loose close to \$ 700 billion dollars every year to fraud.
- Losses due to fraud are added to the cost of doing business.
- If a company nets 20% profit in sales of a product, they must sell five times at the regular prices to recover losses from fraudulent transaction worth that one product.



Fraud Impact to business

- One axiom of fraud is that it is hidden.
- Those organisations that take proactive steps to prevent or detect fraud have significantly lower levels of misappropriation.
- Therefore educating executives about fraud is the only logical first step towards controlling fraud.
- Every organisation is expected to have an integrated strategy for fraud prevention and control.
- Those organisations with an integrated strategy are less likely to suffer catastrophic losses than those without.



CORPORATE FRAUD AND ABUSE CLASSIFICATION SYSTEM

Corruption

Conflicts of Interest

Purchasing Schemes

Sales Schemes

Other

Bribery

Invoice Kickbacks

Bid Rigging

Other

Illegal Gratuities

Economic Extortion

Asset Misappropriation

Cash

Theft

Cash on Hand

From the Deposit

Other

Skimming

Sales

Unrecorded

Understated

Receivables

Write-off Schemes

Lapping Schemes

Unconcealed

Refunds and Other

Fraudulent Statements

Financial

Asset/Revenue Overstatements

Fictitious Revenues

Timing Differences

Concealed Liabilities and Expenses

Improper Asset Valuations

Asset/Revenue Understatements

Non-Financial

Employment Credentials

External Documents

Internal Documents

Non-Cash

Misuse

Theft

Asset Requisitions and Transfers

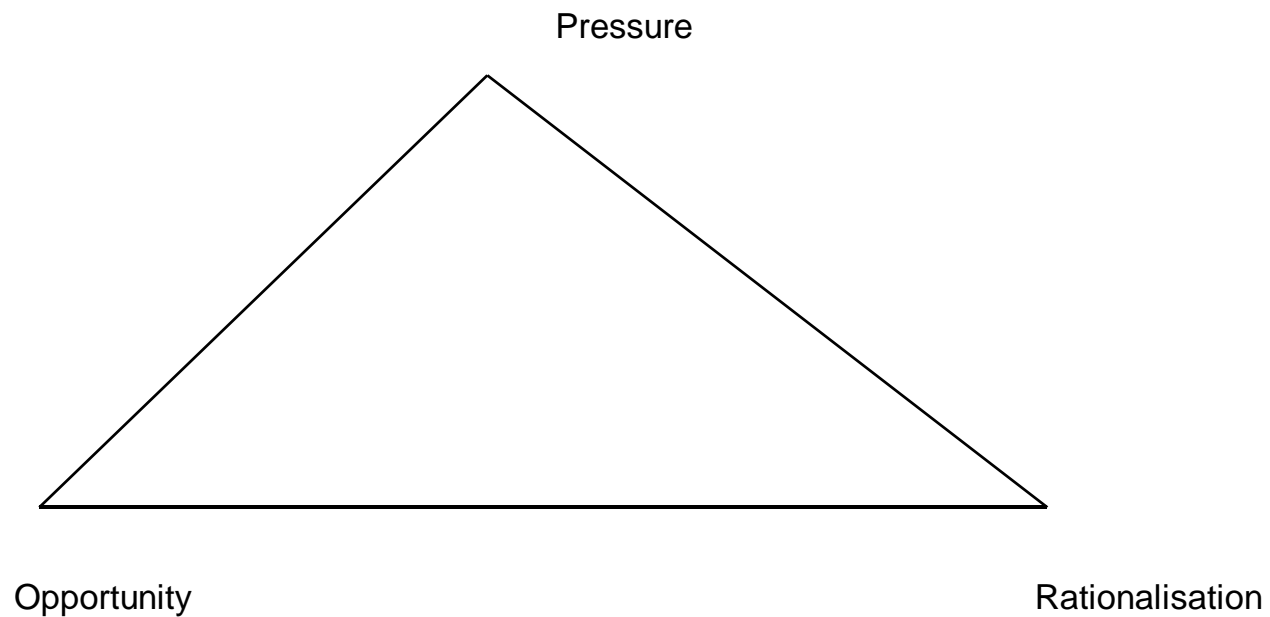
False Sales and Shipping

Purchasing and Receiving

Unconcealed Theft



Characteristics of fraud - The Fraud Triangle

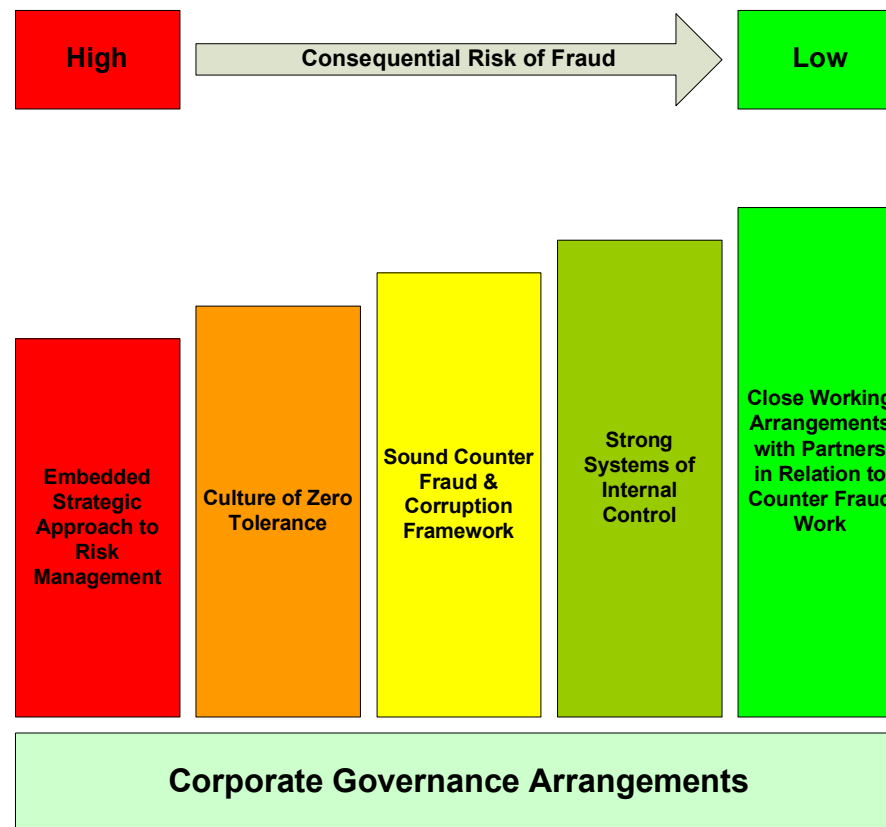


Fraud Characteristics

- There are generally three requirements for fraud to occur - motivation, opportunity and personal characteristics.
- Motivation is usually situational pressures in the form of a need for money, personal satisfaction, or to alleviate a fear of failure.
- Opportunity is access to a situation where fraud can be perpetrated, such as weaknesses in internal controls, necessities of an operating environment, management styles and corporate culture.
- Personal characteristics include a willingness to commit fraud. Personal integrity and moral standards need to be flexible enough to justify the fraud, perhaps out of a need to sustain a certain life style .
- It is difficult to have an effect on an individual's motivation for fraud. Personal characteristics can sometimes be changed through training and awareness programs
- “ Opportunity is the easiest and most effective requirement to address to reduce the probability of fraud.
- “ By developing effective systems of internal control, you can remove opportunities to commit fraud.



Fraud Prevalence: Improving Corporate Governance Arrangements



A Strategic Approach to the General Management of Risk

Key elements for the strategy include:

- “ A published organizational strategic approach to managing risk that has been agreed at executive and, where relevant, political level.
- “ Ownership of fraud risk at corporate management level (Compliance Manager or Risk Manager, etc).
- “ Adoption of an approach consistent with that set out in a recognised risk management standard .
- “ A standard approach across the organisation to operational procedures for managing risks.



Adopting a culture Designed to Deliver 'Zero Tolerance' of Fraud

Key elements of an anti-fraud culture include:

- “ A published Code of Corporate Governance that has been agreed at executive level, linked to the setting of high ethical standards.
- “ Governance arrangements that support the process, including an independent Audit Committee (one of the directors ought to be knowledgeable in anti-fraud issues)
- “ Published Codes of Conduct for staff and officers and training programmes to embed the requirements (I am also professional trainer on anti-fraud education in corporates) .
- “ Strong leadership and senior management support of those charged with managing the risk of fraud.
- “ Firm and effective action against those found guilty of fraud and appropriate publicity to deter potential fraudsters.



Organizational/corporate Anti-Fraud Framework

Key elements include:

- “ A published Anti-Fraud and Corruption Strategy/Fraud Response Plan/Fraud Policy that has been agreed at executive level
- “ A programme of “fraud awareness” training that covers both board members, management and staff. (This is best practice globally – I have done this for a major parastatal)
- “ A widely publicised “Whistle blowing” facility that maintains staff confidence and is provided in line with legislative requirements
- “ Budget allocation of adequate levels of financial investment to anti-fraud projects/work and the employment of trained anti-fraud specialists.



Strong Systems of Internal Control

Key elements include:

- “ Documented systems and procedures to support key financial and operational procedures including formal schemes of delegation with regular reviews/ updates.
- “ A formal in-depth annual review of internal control arrangements linked to regular monitoring of key controls, which produces an annual assurance statement/statement of internal control that is considered by those in the organisation charged with responsibility for governance.
- “ An effective investigative function that does not solely deal with reactive issues but has developed, in liaison with internal audit and senior management, a programme of anti-fraud initiatives/projects.



Case – Perspective control weaknesses

POOR SEGREGATION OF DUTIES

- **A woman banker was sentenced to several years in prison for defrauding a bank during her employment as head bookkeeper and later as the operations officer**
- **Over a four-year period, the operations officer made unauthorized electronic transfers by means of block entries from customer accounts into her own accounts as well as accounts of family members and other customers.**
- **The woman avoided detection by developing elaborate means of re-crediting those accounts before the end of their statement cycles, concealing the unauthorized transfers, and creating and distributing false monthly statements.**
- **Moreover, she was in charge of customer inquiries, and bank employees were instructed to direct complaints to her.**
- **She also included false descriptions of transfers and backdated electronic entries.**



Lessons

- **Control frameworks for organizations that rely on electronic transactions are built on automated controls.**
- **In this case, the head bookkeeper, who later became the operations officer, was not deterred from committing fraud by any preventive control.**
- **Without an adequate segregation of duties policy, the operations officer was authorized to process transfers, create and distribute monthly statements, and handle customer complaints.**
- **Weaknesses also existed in the preventive controls around transfers, which allowed her to have unsupervised access to customer accounts and make:**
 - **Transfers from customer accounts to her personal account.**
 - **Transfers just before the end of statement cycles.**
 - **Unauthorized transfers**



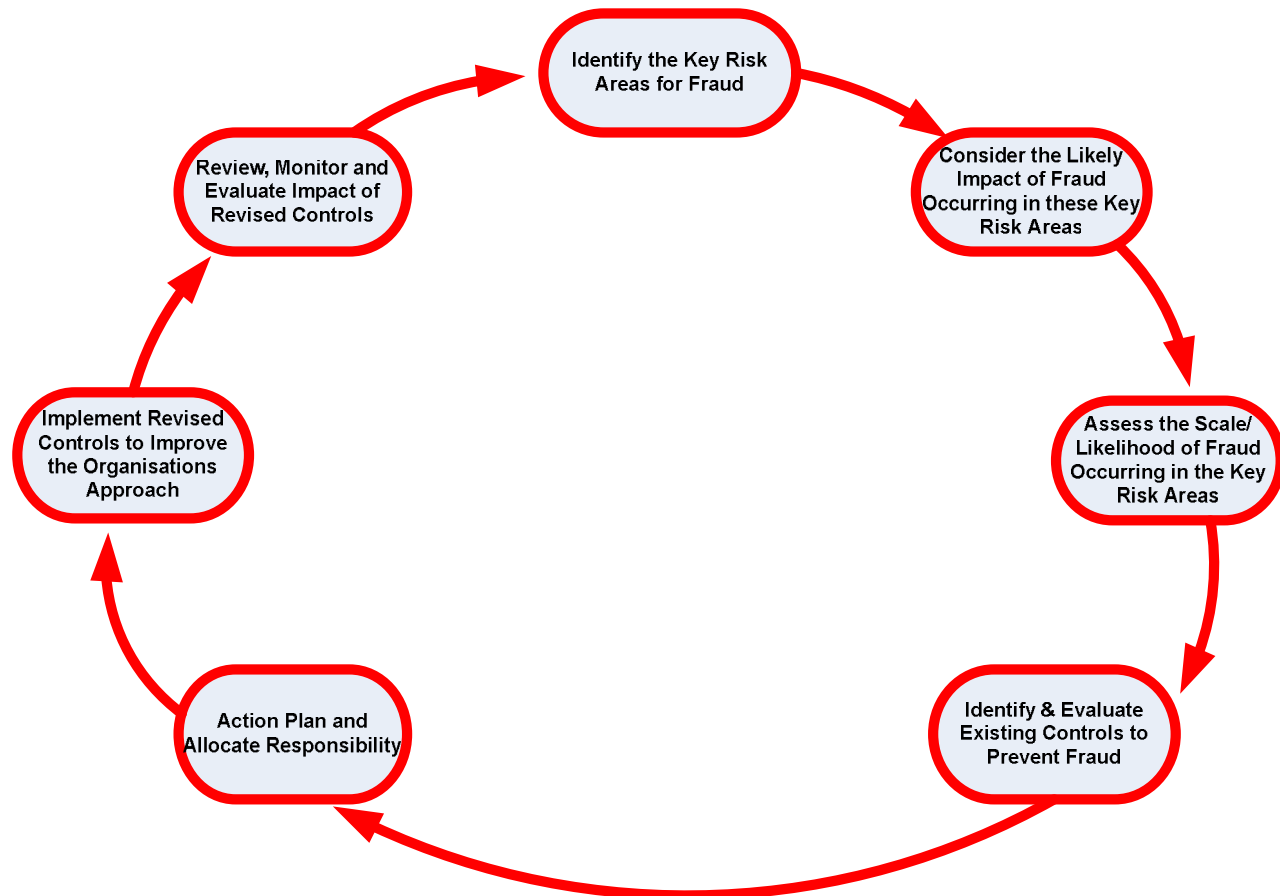
Partnership Working Arrangements

Key elements include:

- “ Managing the risk of fraud is included between the organisation and its key strategic and delivery partners.
- “ Agreements with suppliers, contractors and consultants delivering services to the organisation that are structured to incorporate and agree joint approaches to tackling potential fraud risks.
- “ Established liaison and operational working agreements and the sharing of intelligence with other relevant organisations including police, insurers and other specialists in the areas of fraud avoidance and investigations.



ALARM – Fraud Risk Management Process

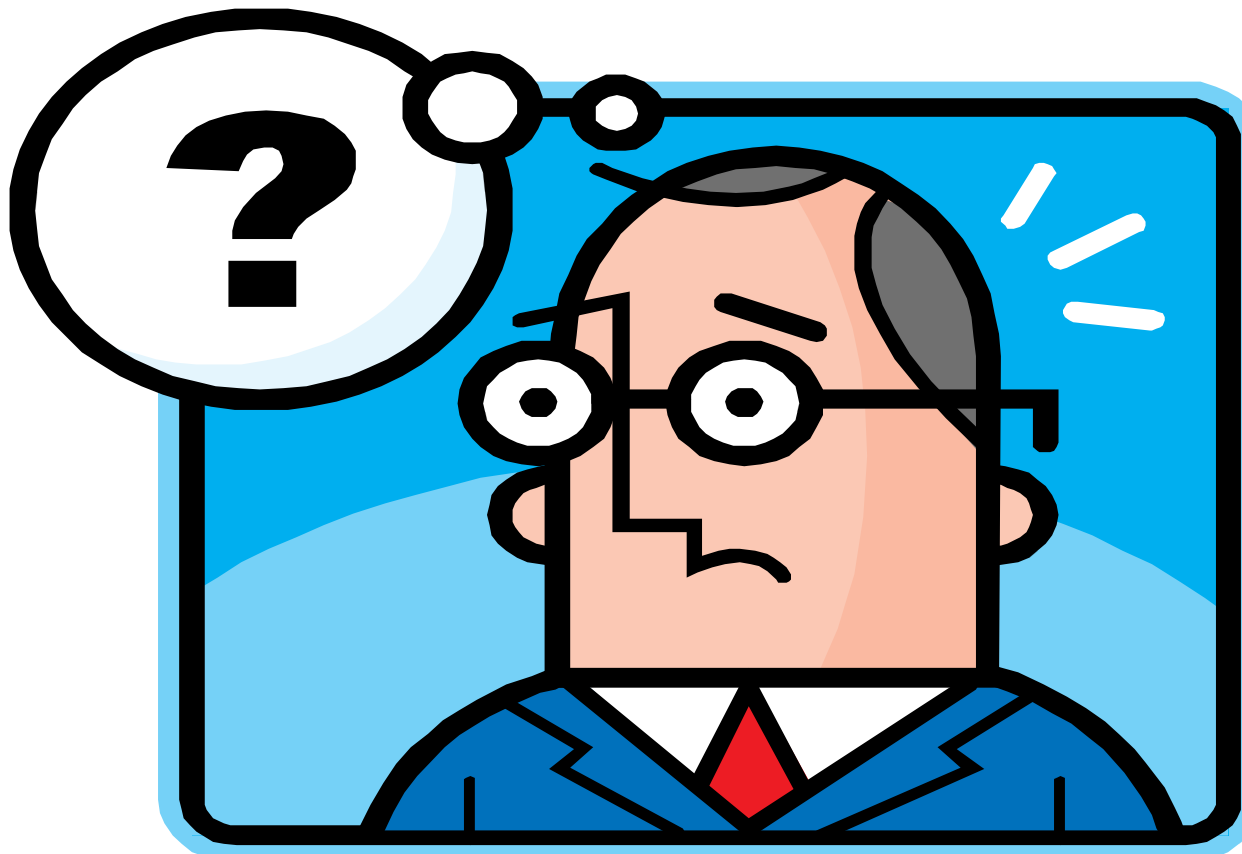


Questions/Comments

- Could fraud be happening in your organisation?
- Where do you start in order to manage it?
- Perform a review of the organization's processes, policies and procedures to establish resilience to detect and deter fraud.
- We will provide management with recommendations for a proactive fraud deterrence program.



Questions / Discussion



Discussion – application to a fraud scenario

In normal business transaction a procurement payment *voucher* is a file that includes:

- **Purchase Requisition**
- **The purchase order (LPO) which was sent to the supplier ,**
- **The supplier invoice which lists the cost and quantity of items purchased, and**
- **The internal receiving reports (GRN/) , which verify that purchased items have been received.**
- **In a purchasing cycle, a completed voucher containing all of these documents is required before the accounts payable department issues a payment cheque to a supplier.**

Procurement billing fraud schemes.

- **A fraudulent billing scheme might necessitate the falsification or alteration of any of the above indicated documents. In general, cash-generating fraudulent billing schemes are built around invoices from shell companies or employee-owned businesses.**
- **In some circumstances, a corrupt/fraudulent employee may utilize invoices from legitimate suppliers to generate fraudulent payments.**
- **What probable legal charges would you contemplate against such fraudsters?**



Thank you

Peter N. Munachewa

Managing Consultant

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Delivering executive development courses on risk management, corporate fraud governance and forensic audit, benchmarking this against best practice for maximizing value.

