



# Proactive Fraud Audit Techniques for Auditors and Investigators

---

PRESENTATION

BY

CPA REUBEN BORO GITAH

*"Your unclaimed assets solutions and compliance provider"*

*[www.one-source.info](http://www.one-source.info)*

# Why should we proactively detect fraud

---

TO AVOID

# Introduction

---

# Current news

---

<https://www.standardmedia.co.ke/article/2000179366/smoke-out-powerful-people-behind-nys-scam>

<http://www.standardmedia.co.ke/article/2000166250/i-stopped-sh826-fraud-at-nys-says-devolution-cs-anne-waiguru>

<http://www.nation.co.ke/news/21-government-officials-named-NYS-scam-report/-/1056/2866948/-/stxpgq/-/index.html>

[Ndathi Speaks-out over Ksh 2 Million Facebook Allegations](#)

Kirinyaga County spends Ksh 2 Milion on Facebook account-

<http://www.standardmedia.co.ke/article/2000175707/protests-rock-bungoma-over-most-expensive-wheelbarrow>

<http://citizentv.co.ke/news/bungoma-residents-protest-ksh-100000-wheelbarrows-100195/>

<http://www.politics.co.ke/news/see-the-nyamira-hospital-gate-that-cost-the-county-just-8m-shillings-only-to-construct/>

<http://mobile.nation.co.ke/news/JSC-sends-Gladys-Shollei-packing/-/1950946/2038778/-/format/xhtml/-/de2qwpz/-/index.html>

<http://mobile.nation.co.ke/news/Why-CJ-is-yet-to-occupy-Sh300m-house/-/1950946/2294676/-/format/xhtml/-/6gt8ts/-/index.html>

**Kenya: Many Contracts At the Judiciary Are Shoddy – Registrar**

**Governor Kidero sacks Leah Oyake over a corruption scandal whose architects are Ndegwa and Kiamba**

<http://en.africatime.com/kenya/articles/governor-kidero-sacks-leah-oyake-over-corruption-scandal-whose-architects-are-ndegwa-and>

<http://mobile.nation.co.ke/news/Why-CJ-is-yet-to-occupy-Sh300m-house/-/1950946/2294676/-/format/xhtml/-/6gt8ts/-/index.html>





<http://www.politics.co.ke/news/see-the-nyamira-hospital-gate-that-cost-the-county-just-8m-shillings-only-to-construct/>





Bungoma County Assembly leader of majority Majimbo Okumu and residents looking at the special Wheelbarrow that costs Sh109,320 at Bungoma town slaughter house. Local leaders and residents want officers involved in the procurement of the 10 Wheelbarrows. PHOTO: TITUS OTEBA/STANDARD Read more

at: <http://www.standardmedia.co.ke/article/2000175707/protests-rock-bungoma-over-most-expensive-wheelbarrow>



<http://citizen.co.ke/news/bungoma-residents-protest-ksh-100000-wheelbarrows-100195/>





Ruto prayers in Meru: MPs sustain attack on CORD, P.10

**Gazette Monday**

**WHEN WEDDINGS GO AWRY**

No. 20964

www.standardmedia.co.ke  
Kilimo/101/000/000/000/000

**THE STANDARD**  
Kenya's Bold Newspaper

Monday, October 12, 2015

# Laugh at how they misuse your cash but it does hurt

State officials devise hilarious but devious ways of spending public money, raising suspicion of graft



## Smoking costs 'Dereva Chunga Maisha' hit singer a foot

By PETER MURURI

More than two-and-a-half decades ago, his authoritative voice ruled the airwaves. His hit single was inescapable in

majority of Kenyan households that had radio sets. It was the voice of reason, which scolded and cautioned drivers on the road to be vigilant. Appropriately titled "Dereva Chunga

Maisha" (Driver save life), Sam Muthoe's most popular hit became like the national anthem for road safety campaigners. Twenty-seven years later, fate has played a cruel joke on Mr Muthoe and

he regrets not heeding his own counsel. Muthoe, who composed the song back in 1988 after watching what he terms as

CONTINUED ON PAGE 3



**KITC**  
Home of technical Education

**KENYA TECHNICAL TRAINERS COLLEGE (KTTC)**  
The school based December 2015 and full time January 2016 intake is ongoing.  
Visit our website: [www.kttc.ac.ke](http://www.kttc.ac.ke) or call: 0722589740/0720436273/0721350595/0726665146  
For detailed information and application.





# Introduction

---

# Introduction

---

Financial Audit: An examination by an independent third party of the financial statements of a company resulting in the publication of an independent opinion on whether or not those financial statements are relevant, accurate, complete and fairly presented.

Forensic Audit: A specialized financial audit performed specifically for the purpose of determining evidence of fraudulent activity and the damages perpetrated by that activity.



# Background

---

The traditional ‘passive philosophy’ towards auditor responsibility for fraud detection is well summarised by the Lord Justice Lopes’ ruling, in the UK, given in the 1896 Kingston Cotton Mill case (re Kingston Cotton Mill Company (No.2)): *‘An auditor is not bound to be a detective, or... to approach his work with suspicion, or with a foregone conclusion that there is something wrong. He is a watchdog, not a bloodhound.’*

# ISA 240

Paragraph	Details
2.	Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional.
4	<p>The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. It is important that management, with the oversight of those charged with governance, place a strong emphasis on fraud prevention, which may reduce opportunities for fraud to take place, and fraud deterrence, which could persuade individuals not to commit fraud because of the likelihood of detection and punishment. This involves a commitment to creating a culture of honesty and ethical behavior which can be reinforced by an active oversight by those charged with governance.</p> <p>Oversight by those charged with governance includes considering the potential for override of controls or other inappropriate influence over the financial reporting process, such as efforts by management to manage earnings in order to influence the perceptions of analysts as to the entity's performance and profitability.</p>



# ISA 240

Paragraph	Details
5.	An auditor conducting an audit in accordance with ISAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the ISAs.
10.	<p>The objectives of the auditor are:</p> <ul style="list-style-type: none"> <li>(a) To identify and assess the risks of material misstatement of the financial statements due to fraud;</li> <li>(b) To obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and</li> <li>(c) To respond appropriately to fraud or suspected fraud identified during the audit.</li> </ul>

## **Forensic Tools and Techniques for Auditors & Investigators**

---

# **Recognized Investigative Tools and Techniques Used by Forensic Specialists/Fraud Examiners**



## Forensic Tools and Techniques for Internal Auditors

---

1. Public Document Reviews and Background Investigations
2. Interviews of Knowledgeable Persons
3. Confidential Sources
4. Laboratory Analysis of Physical and Electronic Evidence

## Forensic Tools and Techniques for Internal Auditors

---

(cont'd)

5. Physical and Electronic Surveillance

6. Undercover Operations

7. Analysis of Financial Transactions

## Forensic Tools and Techniques for Internal Auditors

---

### **Public Document Reviews and Background Investigations**

- Public Databases
- Government Websites
- County Seat
- Corporate Records
- Internet

# **Public Databases**

- Increasing number of vendors
- Reliability of data
- What type of data is available?



# Forensic Tools and Techniques for Internal Auditors

---



## Government records

- Real Estate records; business registrations

## Corporate Records

- Stock Transfer records; Accounting data; vendors; competitors; customers

## Forensic Tools and Techniques for Internal Auditors

---

### Internet

- Search Engines
- News Sources/Newspapers
- Telephone Numbers and Addresses
- Maps
- Legal Resources
- Government Sites

## Forensic Tools and Techniques for Internal Auditors

---

# Interviews of Knowledgeable Persons

- Interview vs. Interrogation
- Continuous process throughout an investigation
- Gain additional information with each interview
- Evidence from witnesses provides additional leads
- May identify additional witnesses
- Interview the target only after completing the interviews of the peripheral witnesses

## Forensic Tools and Techniques for Internal Auditors

---

# Confidential Sources

- Hotlines
- E-mail
- Letters
- Current Employees
- Former Employees
- Vendors & former vendors
- Customers & former customers



## Forensic Tools and Techniques for Internal Auditors

---

### Confidential Sources (cont'd)

#### Cautions

- Use professional skepticism in assessing information
- Information supplied to discredit or embarrass the target
- Weigh the value of the evidence provided against the possibility that it may be false or cannot be proven
- Validate all evidentiary matter provided
- Do not assure absolute confidentiality

## Forensic Tools and Techniques for Internal Auditors

---

### **Laboratory Analysis of Physical and Electronic Evidence** (cont'd)

- Altered & Fictitious Documents
- physical examination
- fingerprint analysis
- forgeries
- ink sampling
- document dating

## Forensic Tools and Techniques for Internal Auditors

---

# Laboratory Analysis of Physical and Electronic Evidence (cont'd)

## Computer Forensics

- hard disk imaging
- E-mail analysis
- search for erased files
- analyze use & possible misuse
- computer software to analyze data

## Forensic Tools and Techniques for Internal Auditors

---

# Physical and Electronic Surveillance

## Physical

- usually done by law enforcement or PI's
- surveillance cameras
- can also be used to verify addresses for vendors, employees, etc.

## Electronic

- Internet surveillance
- E-mail



# Undercover Operations

- usually a recommendation to use
- can be done
- best left to professionals

## Forensic Tools and Techniques for Internal Auditors

---

# Analysis of Financial Transactions

- Horizontal/vertical analysis
- Authorization of new vendors & employees
- Comparison of employee & vendor addresses
- Detailed matching of persons approving transactions in finance and procurement.
- Analysis of sales returns & allowance account
- Management override of controls
- Different reviews based on known industry fraud schemes

# **Analysis of Financial Transactions**

- Purchase prices and Market price comparisons
- Expiry date checks from Manufacturers websites

# Procurement Fraud Symptoms

---



# Supplier Checks

---

Conduct supplier-to-employee matching. Compare vendor addresses to a clean list of companies, starting with the postal code. “You can use social media to identify undisclosed relationships,” “Also, look for a vendor who is now an employee or someone who is in the system as both a vendor and an employee. Check emergency contact addresses for employees against supplier addresses.”

Look for related party transactions. Research high-risk vendors by obtaining Government records and using the registered agent information to compare those details against employee records.

# Supplier Checks

---

Find suppliers with residential addresses. The suppliers you pay the most money to generally have a physical office. He suggests using a forensic investigator to assist with address verification and cleansing. “By utilizing an address cleansing service you will learn the type of address, whether it’s vacant, seasonal, a commercial mail service, etc.

Review early payment exceptions. “Some fraudulent vendors will request accelerated or expedited payments,”. “Run a report of payments and look for those who are getting quick payments.”

Use third party data sources, such as PIN and VAT matching.

“Use 3<sup>rd</sup> party data to find bad or black listed vendors,”.

# Invoice Red Flags

---

## Invoice Red Flags

There are other areas of the disbursement cycle that can be monitored for suspicious characteristics. Invoices, for instance, are a valuable source of data. “Pull physical invoices and check for red flags,”

Some red flags to look for are:

- Consecutive invoice numbers
- Even Kenya Shilling amounts on invoices
- Outliers, such as very large or unusual amounts
- Amounts that fall outside the pattern predicted by Benford’s Law



# Digital Analysis using Benford's Law

---

Benford's Law works because nature produces more small things than large things. There are more insects than large mammals, more small houses than large ones, and more small lakes than large bodies of water.

Similarly, businesses produce more transactions with small amounts than with large amounts. Benford's Law predicts that amounts will start with the digit 1 more often than the digit 9, and it even provides a mathematical formula describing the law and percentages.

The digit 1 should show up about 30 percent of the time, while the digit 9 should occur less than 5 percent of the time.

# Outlier Detection

---

One of the primary methods of detecting fraud is discovering data values that are outside the normal course of business.

For example, a kickback scheme might be the reason purchases from one supplier are twice as high as similar purchases from another Supplier.



# Trending

---

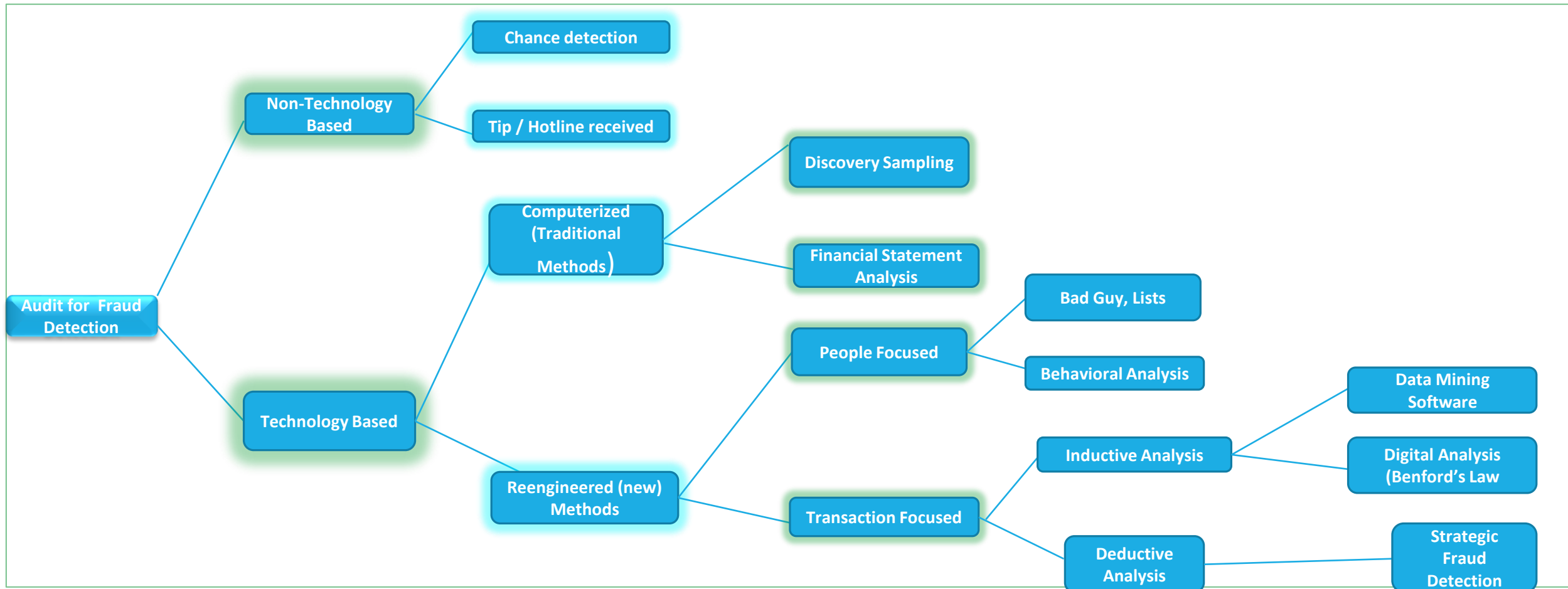
In addition to comparing same period numbers from different vendors, employees, or customers, fraud can be discovered by comparing numbers over time.

Because almost all perpetrators are greedy, fraud increases exponentially over time. Auditors can easily spot an increasing trend on a line chart— computers are not needed if only one item is being audited (one employee, one vendor, etc.).

The need for automation is during the initial phase of a fraud investigation. If auditors do not know which item is increasing, they must look through thousands of graphs to determine which item requires additional investigation.

Trending methods allow the computer to determine which trends are increasing so the auditor can focus on those items. One of the most basic methods of determining an increasing trend is linear regression. Once the computer fits a line to the data, the slope and goodness of fit provide a simple measure of trend.

# Fraud Detection Methods



# Tools

---

## CCTV

## Spread sheets

- Ms-Excel

## Audit software's

- IDEA
- ACL

## Disk Imaging software

- Encase
- Forensic Tool Kit-(FTK)

# Data Analysis & Search Tools

## Data Analysis

ACL - <http://www.acl.com/products/>

- Desktop - "traditional" data analysis tool with various file interoperability, built-in analysis functions, and custom-language scripting / automation abilities
- Exchange - data feeds, functions with custom parameters, documentation acquisition and storage, Microsoft Office integration, and data exception identification and workflow
- Acerno-Excel Add-In for results analysis

IDEA - <http://www.caseware.com/products/idea>: Data analysis tool with various file interoperability, built-in functions, and custom-language scripting / automation

Active Data/ Active Audit-Excel Add-Ins for data analysis similar to IDEA and ACL

### Search Websites

- Craigslist / EBay search: <http://www.searchtempest.com/>
- Person or Company profiling: <http://www.zoominfo.com/>
- Address or Phone search: <http://www.zabasearch.com/>
- Social Media search: <http://www.kurrently.com/>
- Blog Search: <http://technorati.com/>

# Open Discussion

Questions  
?  
Thankyou





## Services Offered

Internal audit

Fraud Risk Assessment

Forensic Investigations

Fraud Training & Awareness Programs

Anti-money Laundering

Pre-employment Integrity interviews

Loss Prevention Consulting

Dispute Advisory

Due Diligence Investigations

Background Screenings

Unclaimed Financial Assets compliance and reporting audits

### Contact Details

**Reuben Boro Gitahi**

**Director Forensic Risk and Compliance Services**

**OneSource Financial Services Limited**

**+254-722-372677**

**[reubenborogitahi@gmail.com](mailto:reubenborogitahi@gmail.com)**

**[Reuben.gitahi@one-source.info](mailto:Reuben.gitahi@one-source.info)**

**[www.one-source.info](http://www.one-source.info)**