



The 2016 FORENSIC AUDIT CONFERENCE

Fraud Detection & Prevention in financial services

Dealing Emerging Fraud Trends



The payments world is rapidly advancing technologically and globally, giving rise to many future payment possibilities for users and similarly allowing merchants to attract and connect with others around the world. It is now possible for a user to make payments on the move via mobile devices, enjoy access to multiple payment methods and currency options and feel secure in the knowledge that their sensitive data is protected due to new tools being developed to combat fraudulent activity.ⁿ *for keeping them accountable for common good and market at large.*

Agenda

1	Introduction
2	Definition
3	Financial Services Fraud Typologies
4	Fraud Report
5	The Governance
6	Fraud Risk Assessment
7	Conclusion

768 senior executives from a broad range of industries worldwide were polled this year—and the results yielded some surprising insights. The overall picture is that fraud has continued to increase, leaving businesses feeling more vulnerable and at risk than ever before-*Kroll*

Introduction : The Noise in Kenya

Why the Cry;

- Greed by the Powerful and leader
- Financial Services governance talk –Dubai Bank, Chase Bank, Imperial Bank, National Bank
- Get rich quick mindset by most
- Moral decay in society/Loss of Ethical lifestyle.
- Executive incentives that attract BAD Behavior
- Unrealistic Performance expectations—rewards for short-term behavior
- Nature of accounting (corruptible) rules
- Inadequate laws, systems, standard and will
- Educator failures
- Common good no more ... Triple bottom line reporting

(Power + Authority) – (Accountability) – (Ethics) = Corruption

(Incentive Opportunity + Rationalization) – (Ethics) = Fraud

Introduction : Usual News-an Example

- ❖ Corporate governance in Kenya has been an issue which has led to the loss of investor's wealth in the tune of KSh 264 billion. The Chase Bank, CMC, Imperial Bank, Uchumi, Mumias, Kenya Airways, National Bank and TransCentury
- ❖ MYC4 microfinance partners, Kenya Entrepreneurship Empowerment Foundation (KEEF) defrauded Kes. 112 million in investor funds including accrued interest on the defaulted portfolio.

Insurance fraud more than triples to Sh324 million

Inside Harambee Sacco's mega fraud

SHARE BOOKMARK PRINT RATING ★★★★★



PHOTO | FILE The headquarters of the Ethics and Anti-Corruption Commission in Nairobi. Its officials are investigating fraud at Harambee Sacco. NATION MEDIA GROUP

By David Mugwe

Posted Sunday, December 9 2012 at 18:38

IN SUMMARY

- The anti-corruption agency acknowledged receipt of the report and said it had launched investigations into the matter.
- In one of the schemes highlighted in the dossier that has been presented to the EACC, Harambee Sacco members paid loans and cashiers made entries into the computers, but for some reason the money was not banked.
- One cashier could not explain the whereabouts of Sh324 million while another could not account for Sh30 million. The amounts were way above the limits cashiers are allowed to hold.
- In another scheme, directors, employees and members got huge cash payments as loans and had the transactions deleted from the Sacco's system, leaving them with no debt obligations.
- Members and outsiders further used automated teller machines to rob the Sacco of more than Sh100 million.

Definitions

What is fraud?

Fraud -Fraud is any intentional act or omission designed to Deceive others, resulting in the victim suffering a loss and/or the perpetrator achieving a gain.

Managing the Business Risk of Fraud: A Practical Guide, prepared by IIA, AICPA, and ACFE

What is Corruption?

Corruption is the abuse of public or private office for personal gain. It includes acts of bribery, embezzlement, nepotism or state capture. It is often associated with and reinforced by other illegal practices, such as bid rigging, fraud or money laundering

OECD

The term *fraud* has come to encompass many forms of misconduct.

Generally attempt to deceive another party to gain a benefit, Act involve a violation of trust.

The violation, resulting financial loss, crime and harm t victim

Financial Services Fraud Typologies: Online Banking Fraud



WHAT IS ONLINE BANKING FRAUD?

Fraudsters take over a victim's online banking account through their modus operandi like man-in-the-middle attack, phishing & money mules.

41%

of global customers who were targeted by online financial fraud failed to recover any money back

17%

of cases reported had money disappearing during an e-banking sessions



\$1.5 Billion

lost to phishing alone in 2012 globally

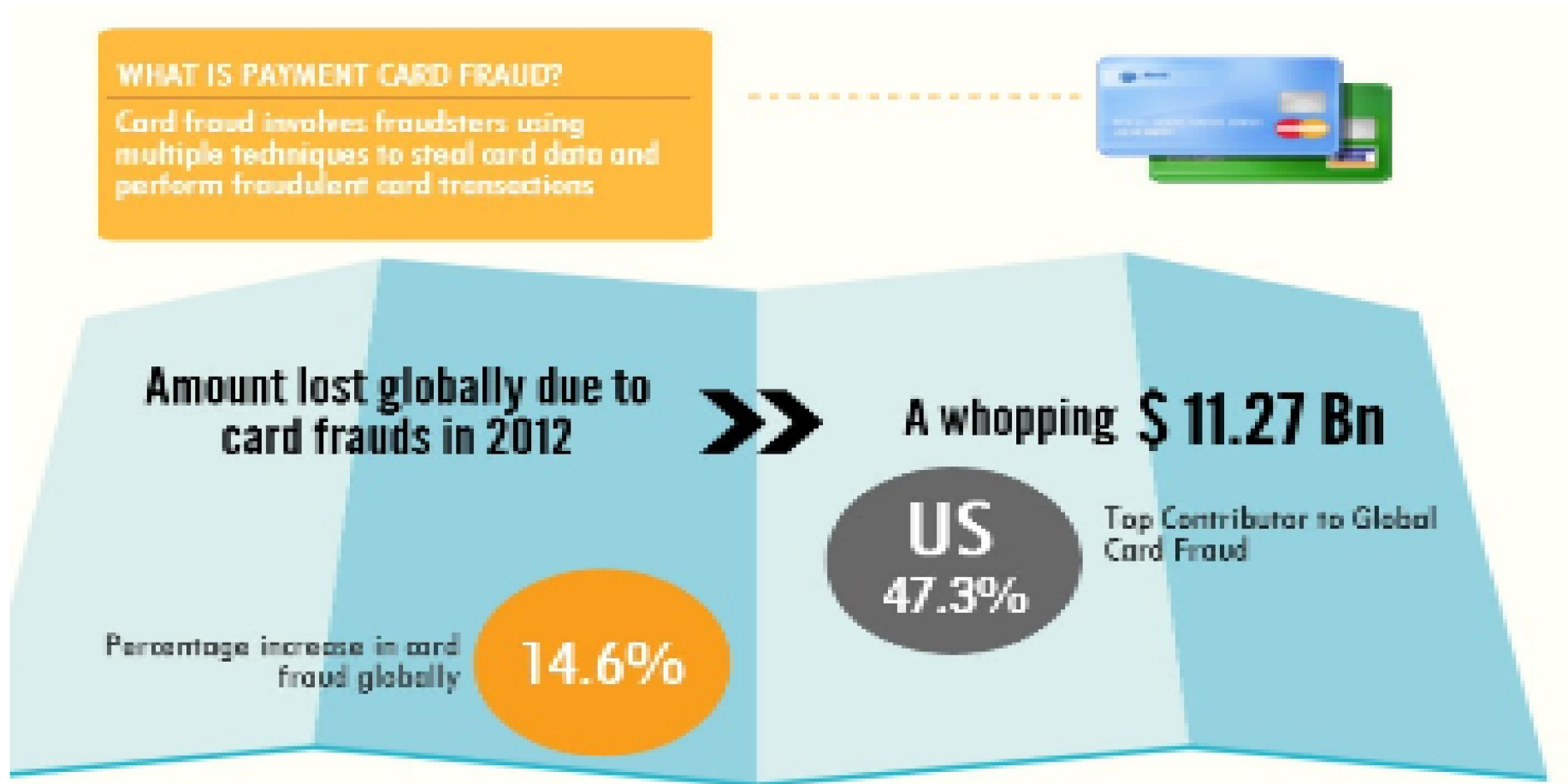
FRAUD LOSSES



₹1.3 Billion

lost by Indian Banks to cyber fraud in a year

Financial Services Fraud Typologies: Card Fraud



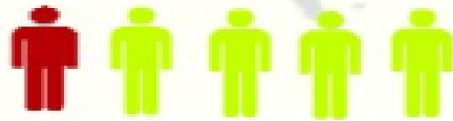
Source : CustomerXPs

Financial Services Fraud Typologies: Insider Fraud

WHAT IS INSIDER/EMPLOYEE FRAUD?

Fraudulent activities are commonly done by bank's employees leading to revenue leakages and financial loss

72%
of organizations
worldwide are plagued
with insider fraud



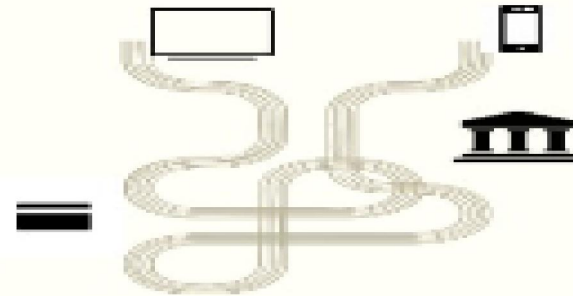
In EMEIA* region, 1 out of every 5 personnel is knowledgeable of financial manipulation in their company

*EMEIA stands for Europe, Middle East, India & Africa

Financial Services Fraud Typologies: Others

WHAT ARE CROSS-CHANNEL FRAUDS?

These are complex fraud schemes where a series of activities are done across different banking channels to perform fraudulent transactions.



**32928
cases**

of ATM, Debit/Credit cards & Internet Banking were registered in last 3 years in India alone

WHAT IS MONEY LAUNDERING?

Money laundering involves concealment of the origins of illegally obtained money, typically by means of transfers involving foreign banks. In order to tackle money laundering, banks need a real-time Anti-money Laundering (AML) solution to effectively combat financial crime

88%
bankers surveyed globally
by KPMG say AML is a
priority

Source : CustomerXPs

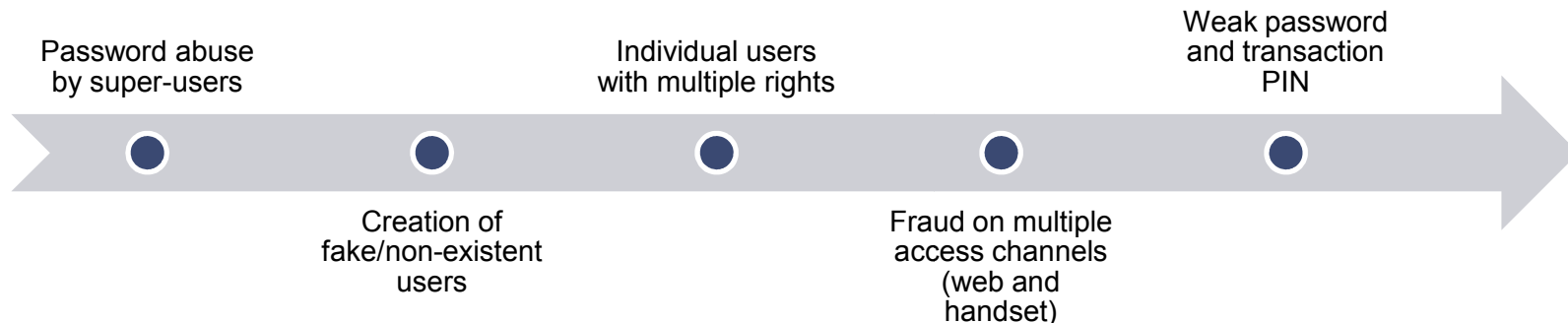
Financial Services Fraud Typologies: Payment

- **Paper based**
 - Cheques
 - Dividend/Interest warrants
 - Demand Drafts/Pay orders
- **Electronic**
 - CTS (Cheque Truncation System)
 - RTGS
 - ECS – Debit and Credit
 - ATMs
 - Credit cards including prepaid
 - Internet Banking
 - Mobile Banking

Financial Services Fraud Typologies: Security Risks

The three major information security risks related to Digital/ e-money are:

- Internal Fraud-DB's, Collusion, Access , vendor
- Hacking into bank computer systems through exploitation of technical vulnerabilities,
- Intentional or accidental data loss (laptop, tape or other data breeches), and
- Identity theft or unauthorized account access by gaining access keys through theft, phishing, social engineering, or other means.
- The mode of exploitation of these risks varies from one payment system to another (i.e. card, internet, mobile banking etc)



Financial Services Fraud Typologies: overview

Fraudsters have become more sophisticated and more knowledgeable about banks' practices — for instance, they know when and how they call customers to verify fund transfers — and banks, whose technology budgets are stretched thin, sometimes struggle to put up adequate defenses.

Local Examples

- Artificial Spouse- transacting on behalf on customer
- Disappearing Securities
- Duplicate Securities
- Staff accessing dormant Accounts
- Loan under-disburserments
- Insurance Fraud-Printing of insurance
- Free Accounts/connections
- International Call- SIM Box
- Connect payment integrity-Overcharge by volume and pricing inflations
- Fraudulent partnership
- Cyberrisk
- Un-authorised transfers
- Unsecure related parties

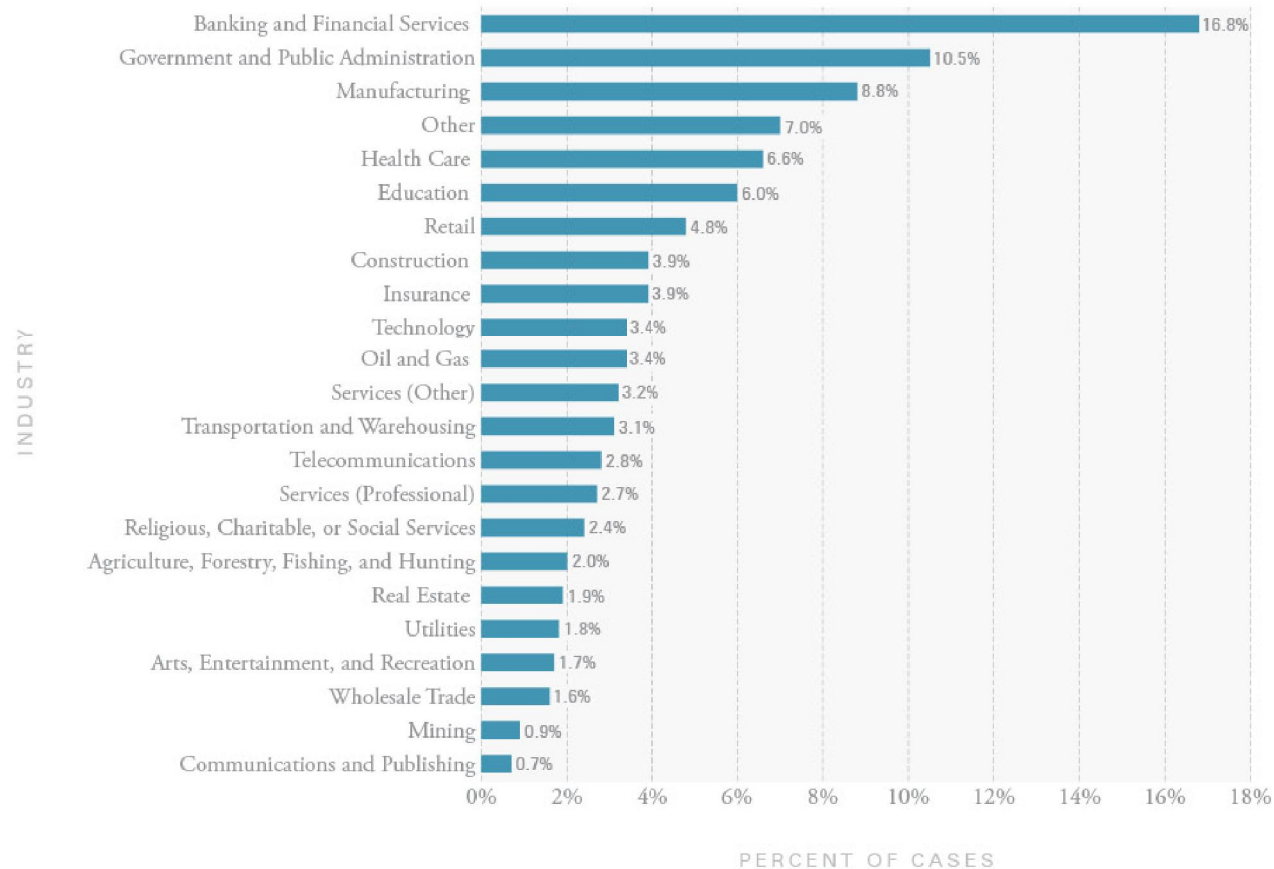
Fraud is rife in the banking system as banks systematically fudge the numbers on loan applications to make borrowers look more creditworthy than they really

Fraud Report: 2016 ACFE Reports to the Nations

- ACFE 2016 global fraud study highlights the current trends for those with an interest in reducing the threat of occupational fraud that include :
 - Estimated losses for a typical organization was 5% of revenues in a given year
 - An average loss per case was \$2.7 million,
 - Asset misappropriation occurred in over 83% of the cases
 - Financial statement fraud occurred in less than 10% of the cases
 - Tips- most common detection method (approximately 39% of the cases)
 - The manufacturing industry was one of the most representative sectors of cases reported (along with banking and financial services and government and public administration)
- The more individuals involved, the higher the losses tended to be.
 - Single perpetrator – \$85,000 loss
 - Two perpetrators – \$150,000 loss
 - Three perpetrators – \$220,000 loss
 - Four perpetrators – \$294,000 loss

Fraud Report: Industry of Organization

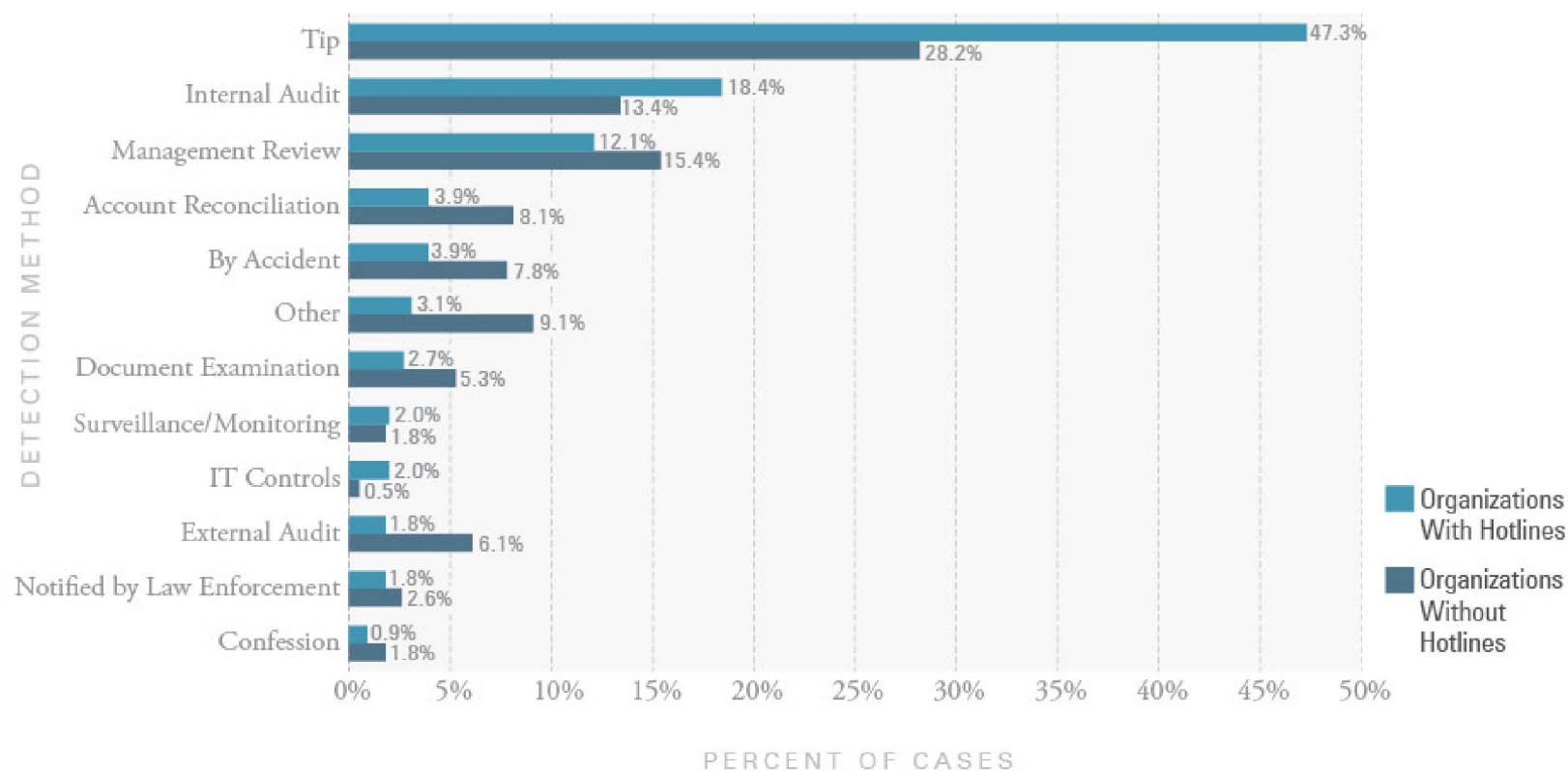
Figure 43: Industry of Victim Organizations



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Fraud Report: Impact of Hotlines

Figure 34: Impact of Hotlines



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Fraud Report: Corruption Cases by Industry

Figure 46: Corruption Cases by Industry

Industry	Total Number of Cases	Number of Corruption Cases	Percent of Cases Involving Corruption
Mining	20	11	55.0%
Transportation and Warehousing	68	35	51.5%
Oil and Gas	74	36	48.6%
Manufacturing	192	93	48.4%
Technology	74	33	44.6%
Telecommunications	62	26	41.9%
Wholesale Trade	36	15	41.7%
Government and Public Administration	229	88	38.4%
Banking and Financial Services	368	138	37.5%
Communications and Publishing	16	6	37.5%
Other	153	57	37.3%
Agriculture, Forestry, Fishing, and Hunting	44	16	36.4%
Construction	86	31	36.0%
Utilities	40	14	35.0%
Real Estate	41	14	34.1%
Retail	104	34	32.7%
Education	132	42	31.8%
Health Care	144	44	30.6%
Arts, Entertainment, and Recreation	37	11	29.7%
Religious, Charitable, or Social Services	52	15	28.8%
Services (Other)	70	20	28.6%
Insurance	85	24	28.2%
Services (Professional)	60	10	16.7%

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Fraud Report: Trends in the Implementation of Anti-Fraud Controls

Figure 49: Change in Implementation Rates of Anti-Fraud Controls

Control	2010 Implementation Rate	2016 Implementation Rate	Change from 2010–2016
Hotline	51.2%	60.1%	8.9%
Fraud Training for Employees	44.0%	51.6%	7.6%
Anti-Fraud Policy	42.8%	49.6%	6.8%
Code of Conduct	74.8%	81.1%	6.3%
Management Review	58.8%	64.7%	5.9%
Surprise Audits	32.3%	37.8%	5.6%
Fraud Training for Managers/Executives	46.2%	51.3%	5.2%
Independent Audit Committee	58.4%	62.5%	4.1%
Management Certification of Financial Statements	67.9%	71.9%	4.0%
Rewards for Whistleblowers	8.6%	12.1%	3.5%
Job Rotation/Mandatory Vacation	16.6%	19.4%	2.8%
External Audit of Internal Controls over Financial Reporting	65.4%	67.6%	2.2%
Employee Support Programs	54.6%	56.1%	1.5%
External Audit of Financial Statements	80.9%	81.7%	0.8%

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Fraud Report: Industry of Organization

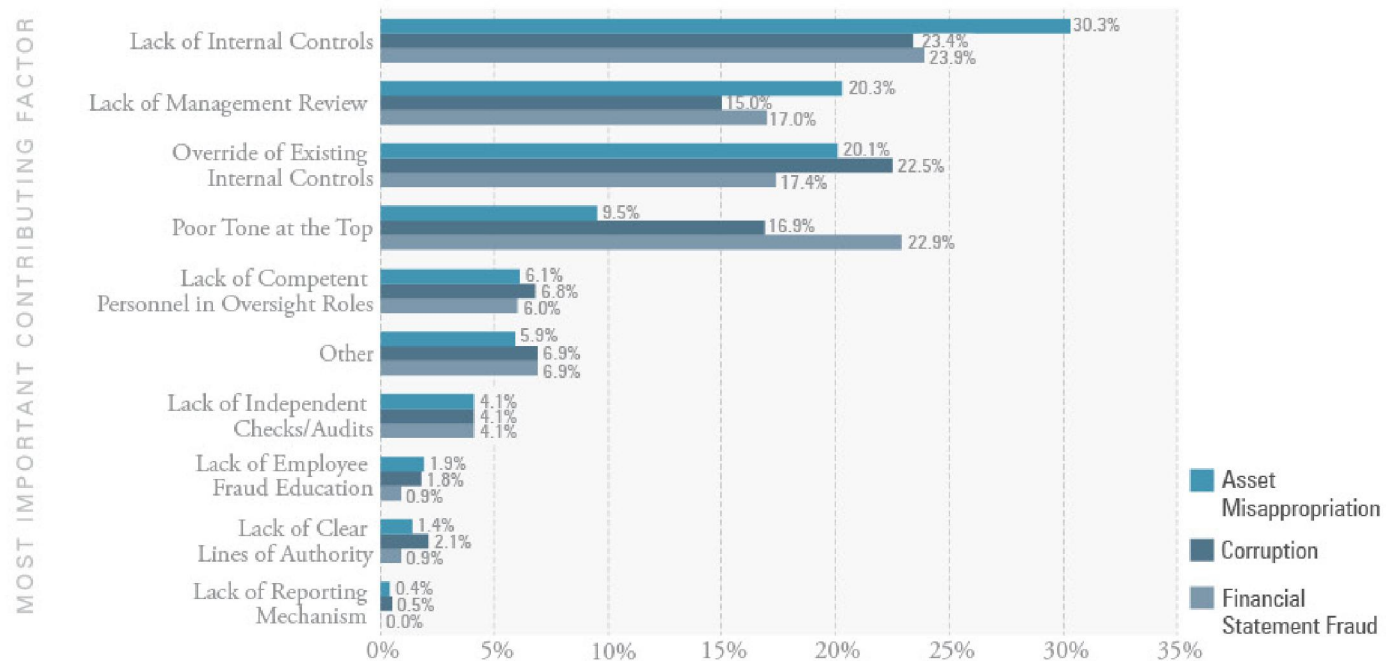
Figure 44: Industry of Victim Organizations (Sorted by Median Loss)

Industry	Number of Cases	Percent of Cases	Median Loss
Mining	20	0.9%	\$500,000
Wholesale Trade	36	1.6%	\$450,000
Services (Professional)	60	2.7%	\$310,000
Agriculture, Forestry, Fishing, and Hunting	44	2.0%	\$300,000
Oil and Gas	74	3.4%	\$275,000
Construction	86	3.9%	\$259,000
Technology	74	3.4%	\$235,000
Communications and Publishing	16	0.7%	\$225,000
Real Estate	41	1.9%	\$200,000
Manufacturing	192	8.8%	\$194,000
Telecommunications	62	2.8%	\$194,000
Banking and Financial Services	368	16.8%	\$192,000
Transportation and Warehousing	68	3.1%	\$143,000
Government and Public Administration	229	10.5%	\$133,000
Health Care	144	6.6%	\$120,000
Insurance	85	3.9%	\$107,000
Utilities	40	1.8%	\$102,000
Other	153	7.0%	\$100,000
Services (Other)	70	3.2%	\$100,000
Retail	104	4.8%	\$85,000
Religious, Charitable, or Social Services	52	2.4%	\$82,000
Arts, Entertainment, and Recreation	37	1.7%	\$75,000
Education	132	6.0%	\$62,000

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Fraud Report: Internal Control Weaknesses That Contributed to Fraud

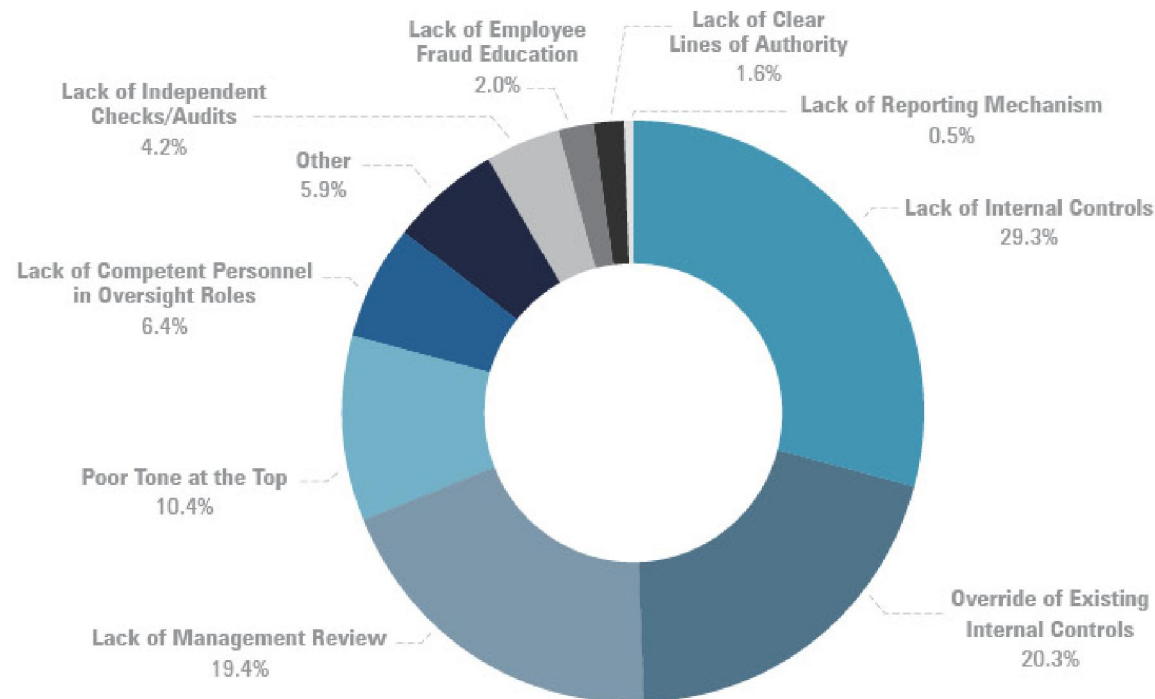
Figure 64: Primary Internal Control Weakness by Scheme Type



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Fraud Report: Internal Control Weaknesses That Contributed to Fraud

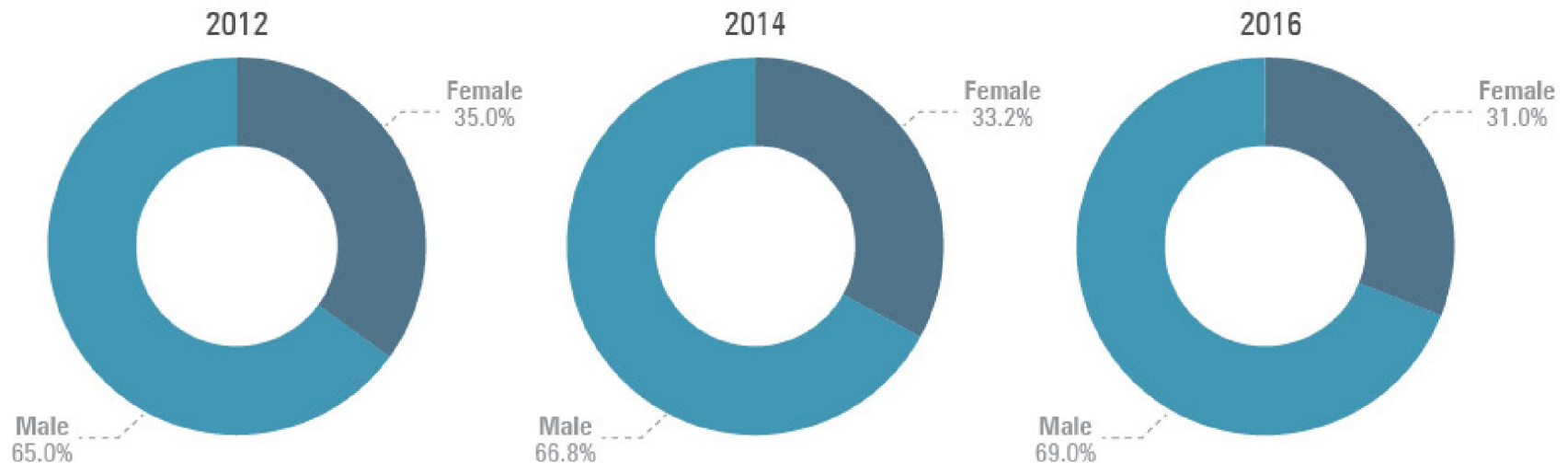
Figure 63: Primary Internal Control Weakness Observed by CFE



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Fraud Report: Perpetrator's Gender

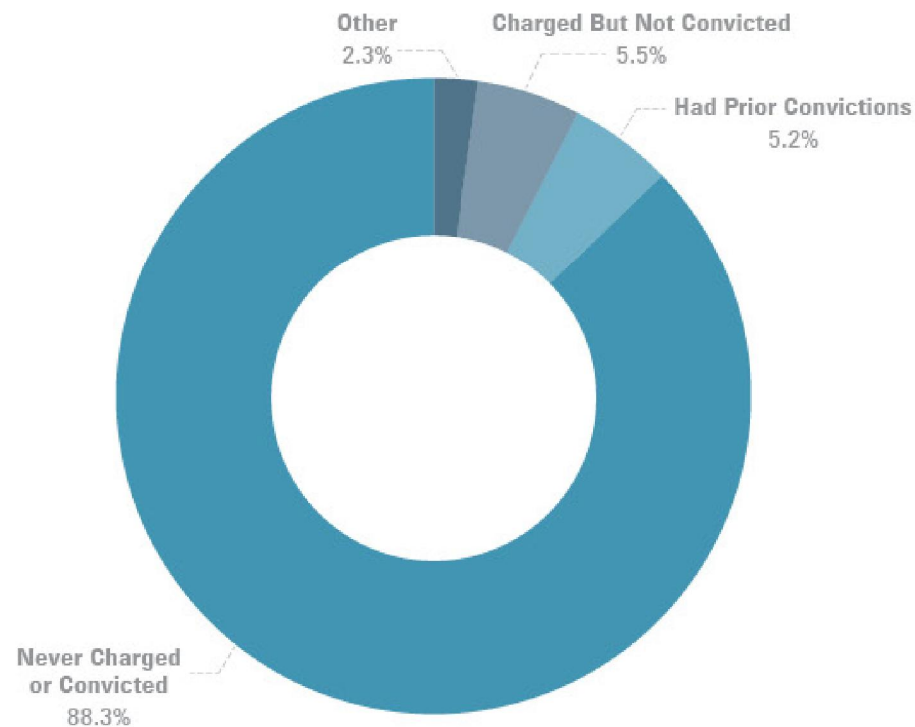
Figure 79: Gender of Perpetrator—Frequency



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Fraud Report: Perpetrator's Criminal Background

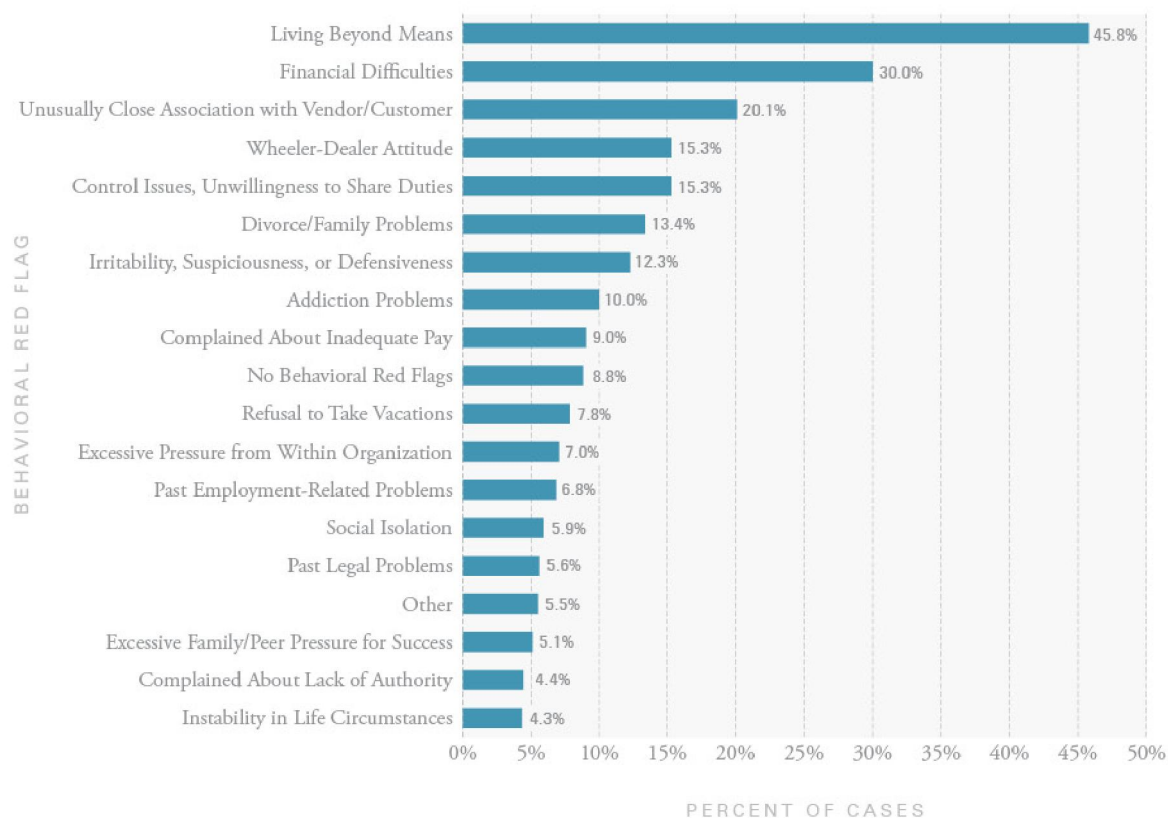
Figure 92: Criminal Background of Perpetrator



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Fraud Report: Behavioral Red Flags Displayed by Perpetrators

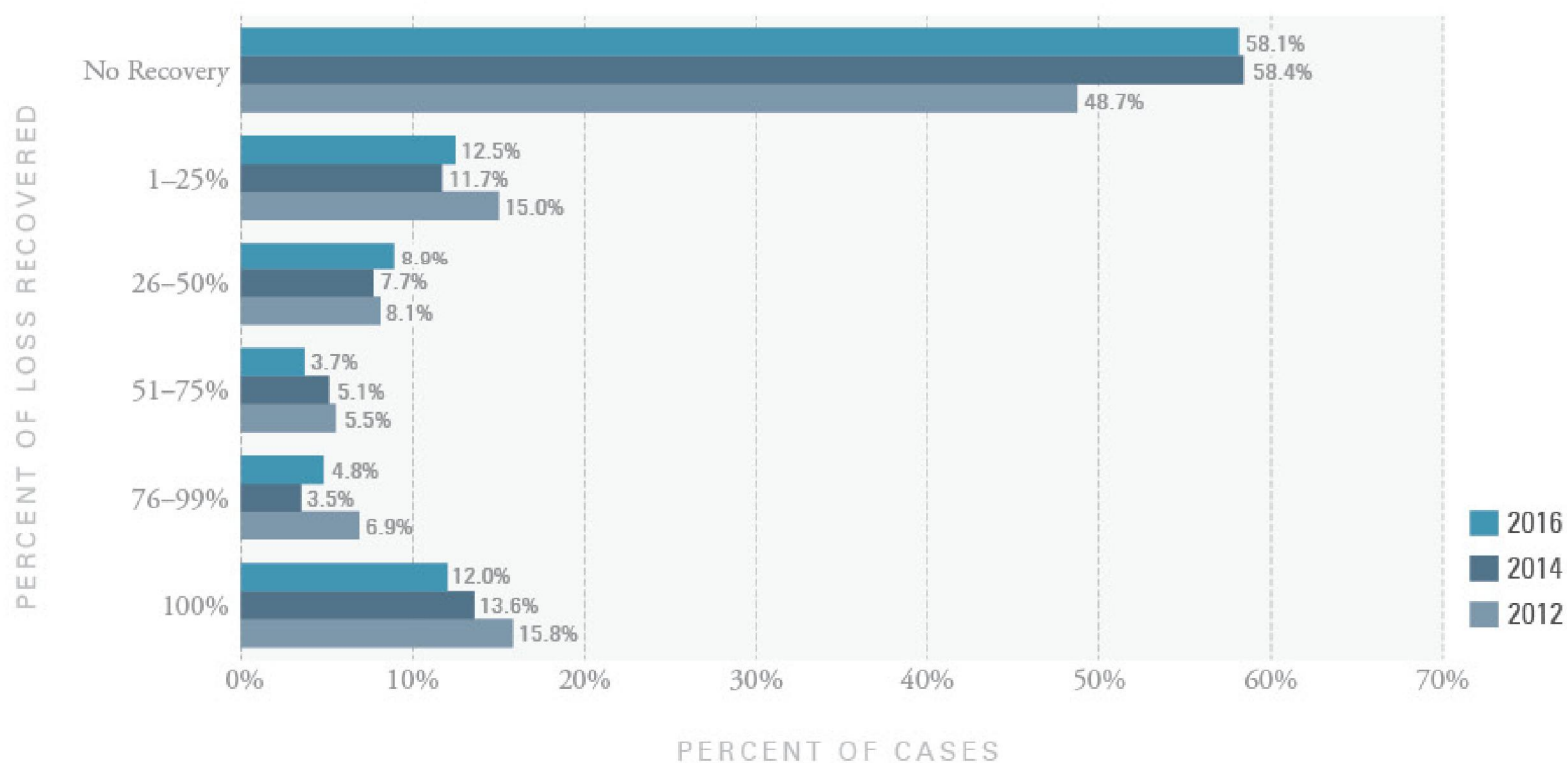
Figure 94: Behavioral Red Flags Displayed by Perpetrators



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Fraud Report: Recovery of Losses

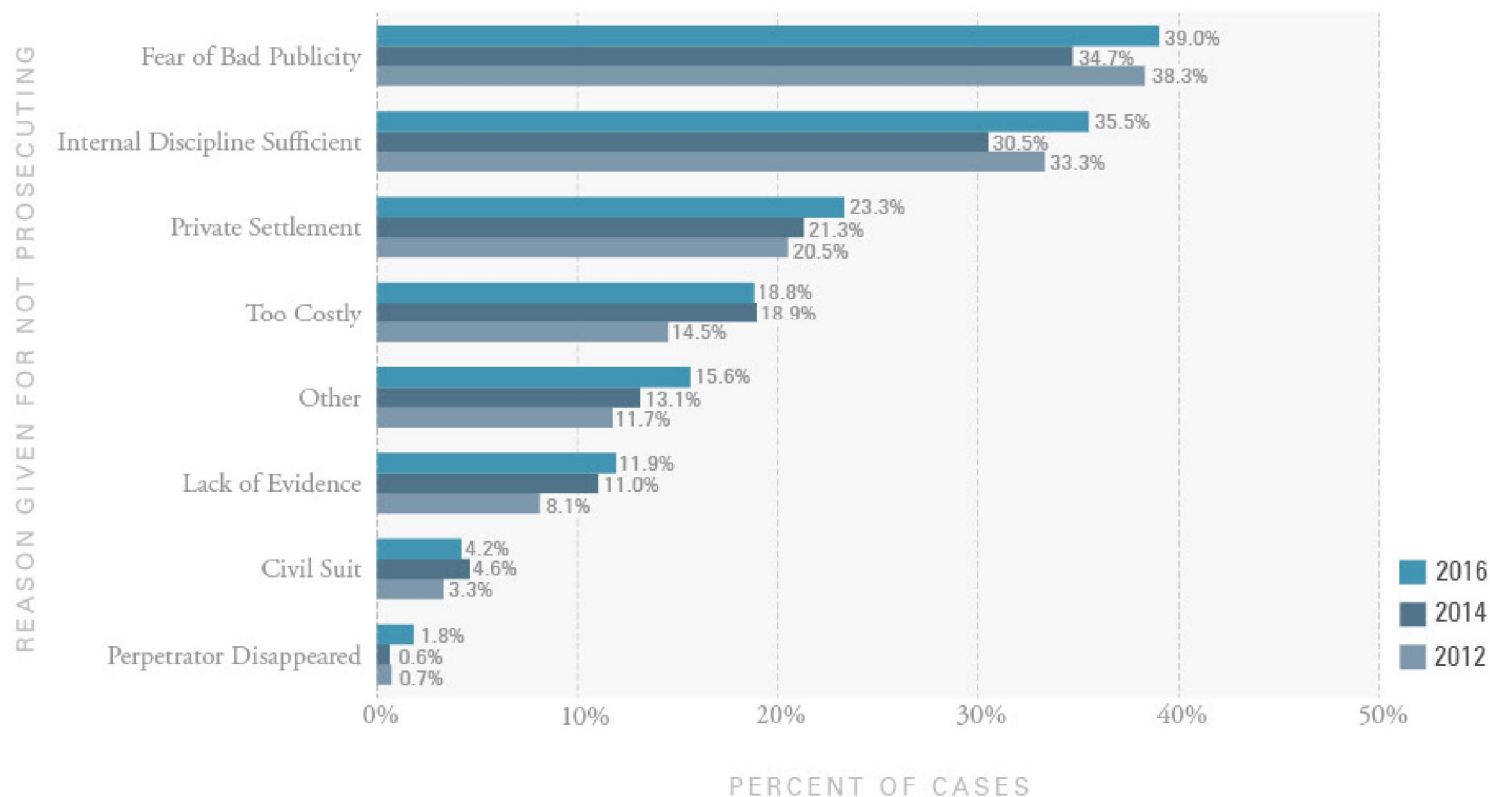
Figure 105: Recovery of Victim Organization's Losses



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Fraud Report: Criminal Prosecutions

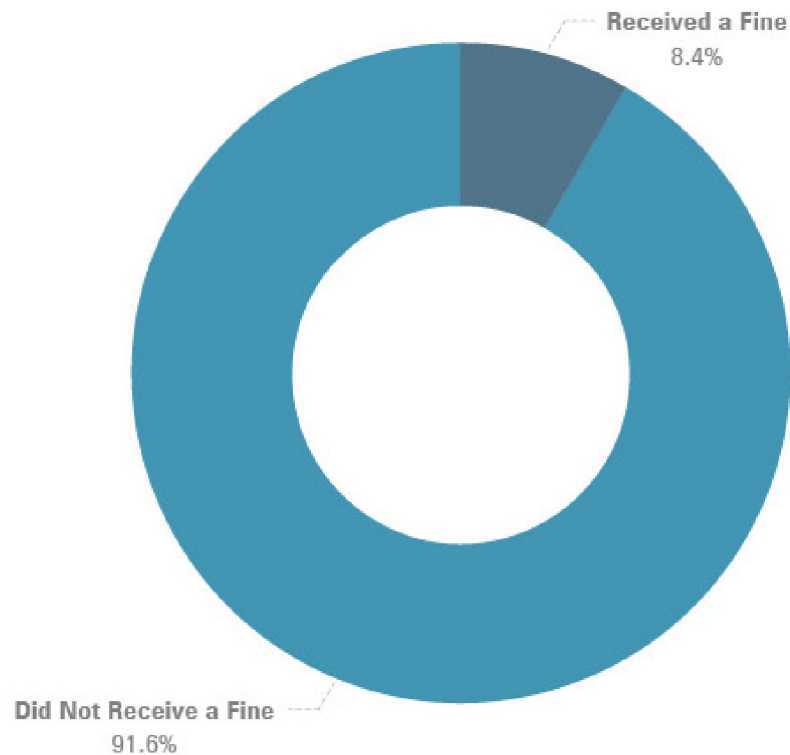
Figure 102: Reason(s) Case Not Referred to Law Enforcement



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Fraud Report: Fines Against Victim Organization

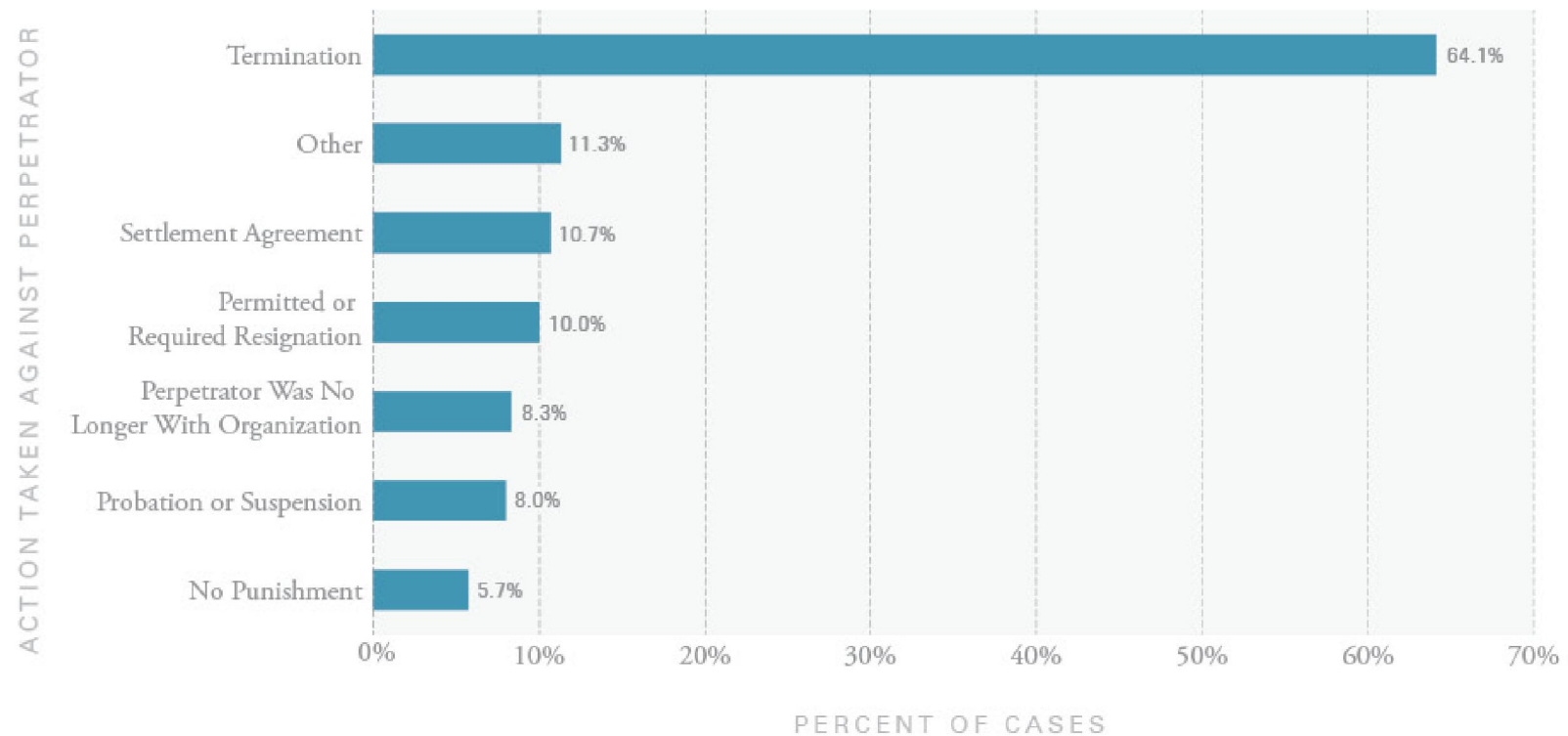
Figure 107: Fines Against Victim Organizations



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Fraud Report: Action Taken Against Perpetrator

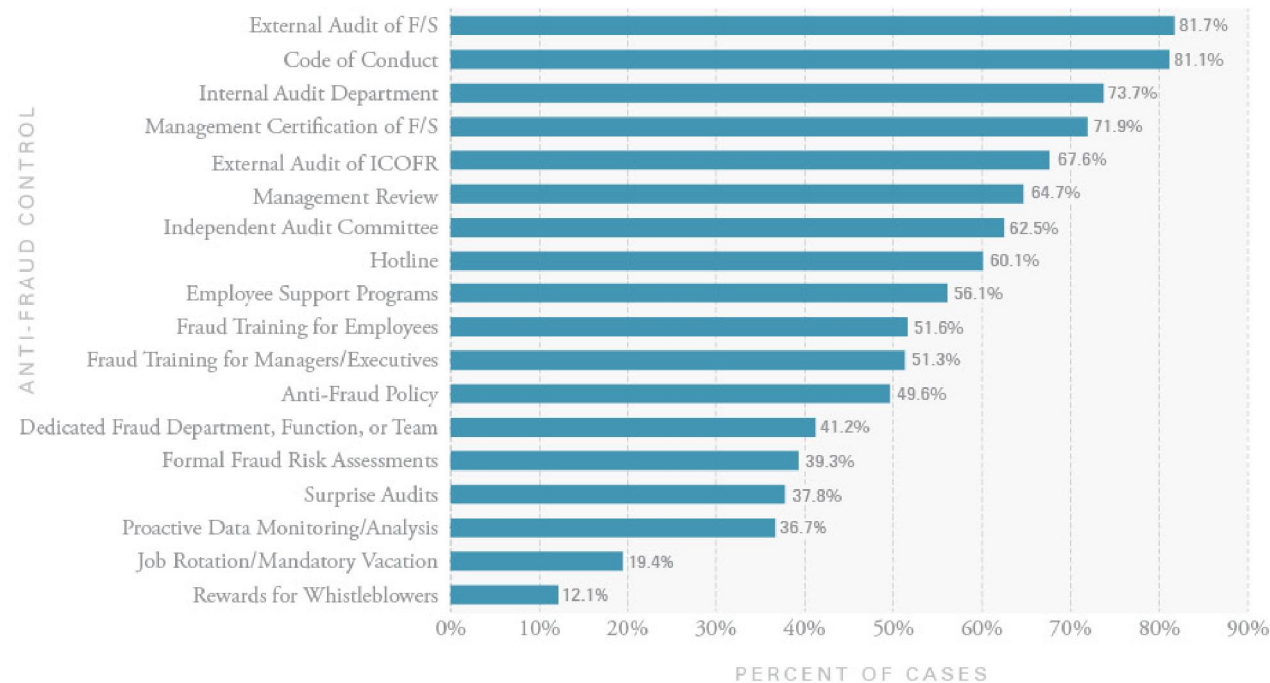
Figure 106: Action Taken Against Perpetrator



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Fraud Report: Anti-Fraud Controls at Victim Organizations

Figure 47: Frequency of Anti-Fraud Controls



Key:

External Audit of F/S = Independent External Audits of the Organization's Financial Statements

Management Certification of F/S = Management Certification of the Organization's Financial Statements

External Audit of ICOFR = Independent Audits of the Organization's Internal Controls Over Financial Reporting

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Corporate Governance: The Board

- The responsibility of individual board members – fiduciary duties of board members, need of skills, personal abilities, training programs on integrity and professionalism.
- The roles/functions of the board – guiding, approving and overseeing strategies/policies rather than being immersed in day-to-day operations.
- Clear accountability lines and internal control systems with sufficient flows of information and managerial support.
- Board Mix – have independent directors and Separate Chair & CEO.
- The committees of the board – audit committee, the Risk Management Committee, The Governance Committee with combined responsibilities of Nomination, remuneration, succession planning, training, performance evaluation, etc.
- • Disclosure – effort on meeting into international standards on accounting, etc. should be encouraged.
- Bank's monitoring of the Corporate Governance structure of its corporate borrowers –
- Extent to which banks should assess/monitor Corporate Governance of their corporate borrowers or seek to improve it

Management's role in fighting fraud

Preventive, Detective and Responsive

- **Management's key responsibility is to ensure proper Internal Control** (Oversight role of those charged with governance-The auditor should obtain an understanding of how those charged with governance exercise oversight of the management process for identifying and responding to the risks of fraud, and whether those charged with governance have any knowledge of fraud affecting the entity)
 - Governance structures to include Fraud risk:
 - Outspoken Anti-Fraud Strategy and policies
 - Ethical environment that sets the right tone (incl. 'Tone at the Top')
 - Fraud risk to be included in risk Assessment
 - Design effective preventive and detective controls
 - Consistent and open response to fraud incidents
 - Report on Fraud

ISA 240 (Redrafted) makes it clear who has the main responsibility for the prevention and detection of fraud: ***'The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.'*** ISA 240 (Redrafted) paragraph 4.

Corporate Governance : Today's Auditor

- 'An auditor conducting an audit in accordance with ISAs is responsible for obtaining reasonable assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.' ISA 240 (Redrafted), paragraph 5.
- Those charged with governance, have the **primary responsibility** for fraud and error, whereas the auditor has a **secondary responsibility**
- ISA 200 (Revised and Redrafted) describes professional skepticism as: 'An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical
- 'The auditor is responsible for maintaining an attitude of professional skepticism throughout the audit.' ISA 240 (Redrafted), paragraph 8.
- The discussion with those charged with governance to take place with particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud might occur.' ISA 240 (Redrafted), paragraph 15
- *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 Millcase (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.' Watchdogs and Bloodhounds(below) a watchdog and a bloodhound?*

Corporate Governance : Element of Integrity Framework

- ❑ Setting Integrity framework:
- ❑ Example setting (Tone at the Top)
- ❑ Senior management Commitment and Leadership
- ❑ Codes of behaviour
- ❑ Allocation of responsibility
- ❑ Ethics culture & committee
- ❑ Effective Oversight & Assurance
- ❑ Communication.
- ❑ Training.
- ❑ Benchmarking.
- ❑ Compliance.
- ❑ Reinforcement.
- ❑ Reporting Complaints.
- ❑ Additional : Staff Support Schemes
- ❑ Regular Fraud Risk Assessment

Corporate Governance : Fraud Maturity

measures

Best practice indicates that the key elements of an anti-fraud program are prevention and timely detection of fraud and misconduct. This is supplemented by effective investigation capability

Your existing anti-fraud control environment can be assessed based on an internationally accepted control framework (ACFE Health check, COBIT, COSO, etc.)

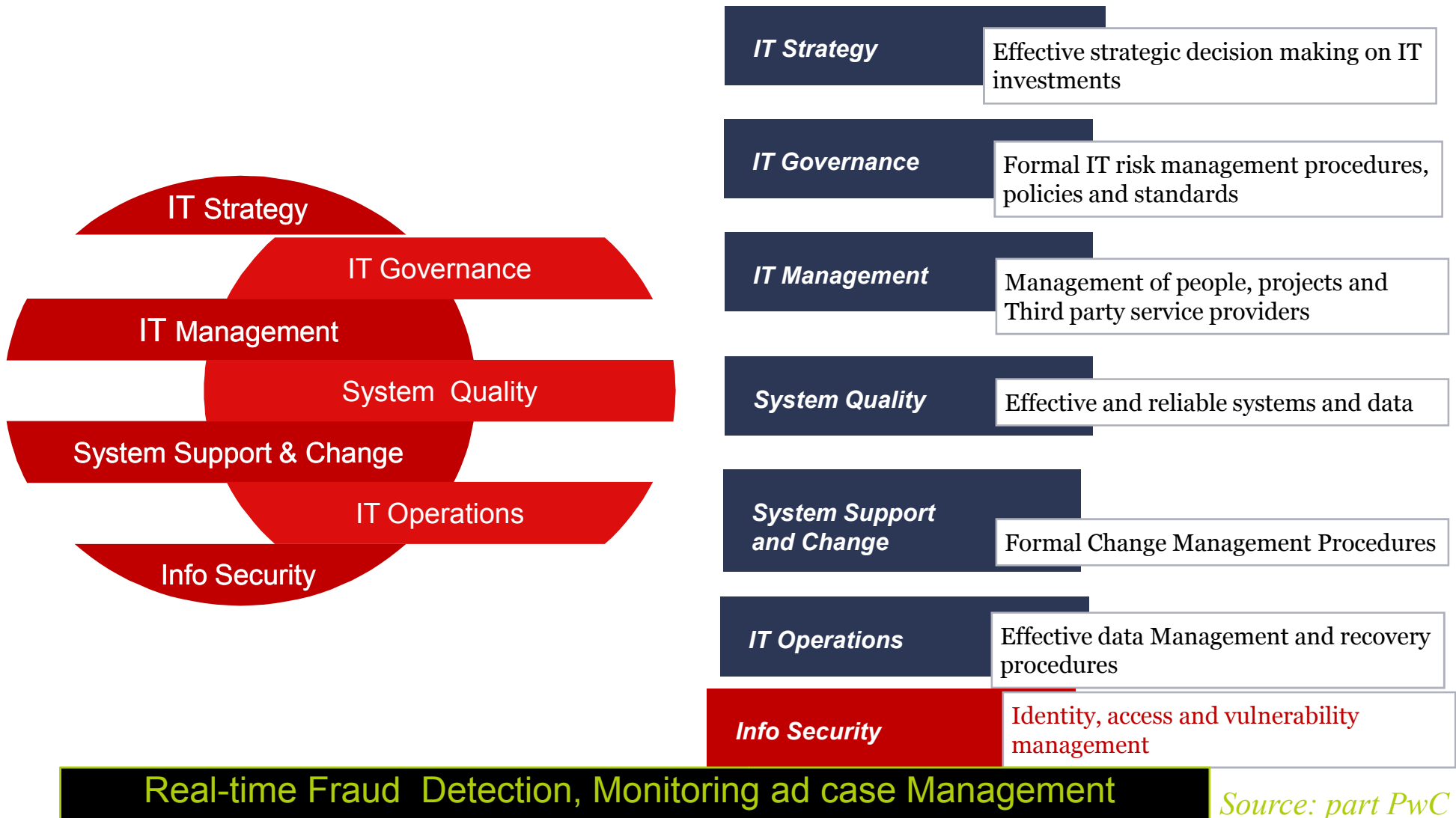
Existing policies and procedures tackling fraud risk will be examined to understand which component of your control framework (control environment, risk assessment, control activities, etc.) they do address.

Corporate Governance : Principals of Managing Fraud Risk

Key principles for proactively establishing an environment to effectively manage an organization's fraud risk include:

- ❑ **Principle 1:** As part of an organization's governance structure, a fraud risk management program⁶ should be in place, including a written policy (or policies) to convey the expectations of the board of directors and senior management regarding managing fraud risk
- ❑ **Principle 2:** Fraud risk exposure should be assessed periodically by the organization to identify specific potential schemes and events that the organization needs to mitigate
- ❑ **Principle 3:** Prevention techniques to avoid potential key fraud risk events should be established, where feasible, to mitigate possible impacts on the organization
- ❑ **Principle 4:** Detection techniques should be established to uncover fraud events when preventive measures fail or unmitigated risks are realized
- ❑ **Principle 5:** A reporting process should be in place to solicit input on potential fraud and a coordinated approach to investigation and corrective action should be used to help ensure potential fraud is addressed appropriately and timely

Corporate Governance IT Governance areas of focus



Source: part PwC

Corporate Governance : The Framework for Fraud Governance

The standards

Enterprise Fraud and Corruption Risk Management Standards

Strategy

Resourcing
Fraud & Corruption Mgt Policy
Corporate Governance Responsibility & Ownership Structures
Training

Prevention

Applying 3 line of Defenses
Fraud & Corruption controls
Risk Governance
Awareness
Internal Controls
Customer Stakeholder/
Suppliers/Procurement Governance

Detection

External Reporting systems
Internal Notification Systems
Detection Systems

Response

Investigations & evidence Management
Controls Reviews
Law and Compliance
Ethics and code of Conduct and Disciplinary systems
Loss Recovery

Fraud Risk Assessment

- ❑ To protect itself and its stakeholders effectively and efficiently from fraud, an organization should understand fraud risk and the specific risks that directly or indirectly apply to the organization.
- ❑ A structured fraud risk assessment, tailored to the organization's size, complexity, industry, and goals, should be performed and updated periodically
- ❑ The assessment may be integrated with an overall organizational risk assessment or performed as a stand-alone exercise, but should, at a minimum, include risk identification, risk likelihood and significance assessment, and risk response
- ❑ An effective fraud risk identification process includes an assessment of the incentives, pressures, and opportunities to commit fraud.
- ❑ Employee incentive programs and the metrics on which they are based can provide a map to where fraud is most likely to occur. Fraud risk assessment should consider the potential override of controls by management as well as areas where controls are weak or there is a lack of segregation of duties
- ❑ Management is responsible for developing and executing mitigating controls to address fraud risks while ensuring controls are executed efficiently by competent and objective individual

Conclusion

- Fraud prevention is becoming a critical driver for the financial services industry this is more driven by increasingly digitized financial services.
- Fraud costs is estimated 5% of revenues Euros a year but this cost nothing compared to the real costs in lost productivity and damage to reputations and customer confidence.
- Without proper governance and controls fraud that goes undetected, impossible to account for and assess.
- The ramifications are far-reaching of failing to management fraud is evident on our market-regulators demands for more pro-activeness in tackling fraud.
- Financial services need to show they can measure and manage risk with active programs that deliver proven benefits. Fraud also damages financial performance at a time when organisations are being compelled to reduce their cost-to-income ratios. Reputational damage is hard to repair and leads rapidly to loss of customers and market share.
- The industry require better ways to fight fraud, without excessive costs or shackles that prevent entities from offering new and innovative services.

Question & Answers

If you can't explain it **simply**, you
don't understand it well enough.

– Albert Einstein

Patrick Gitau, MBA, CERG, CFIA CFE, CRISC, CIA, GRCP

Thank you

