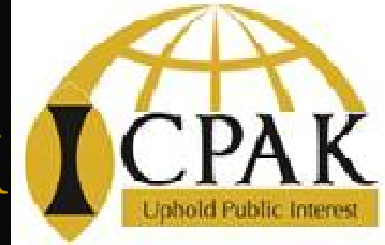


Forensics Audit Seminar- Nyeri



Financial Statement Fraud

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Uphold public interest

Contents



- *Financial statement, contracts and procurement fraud investigations and the litigation process*
- *Integrating effective fraud risk management into the audit plan*
- *Case Study on Financial statement, contracts and procurement fraud Analysis: Lessons learnt and way forward*

Financial Statement Fraud



***Fraud** is an intentional deception made for personal gain in order to obtain unauthorized benefits (money, property, etc.)*

- ” A representation about a material fact, which is false*
- ” Made intentionally, knowingly, or recklessly*
- ” It is believed by the victim*
- ” And acted upon by the victim*
- ” To the victim’s detriment*

Classifications of Fraud



Asset Misappropriation- a scheme that involves the theft or misuse of an organization's assets

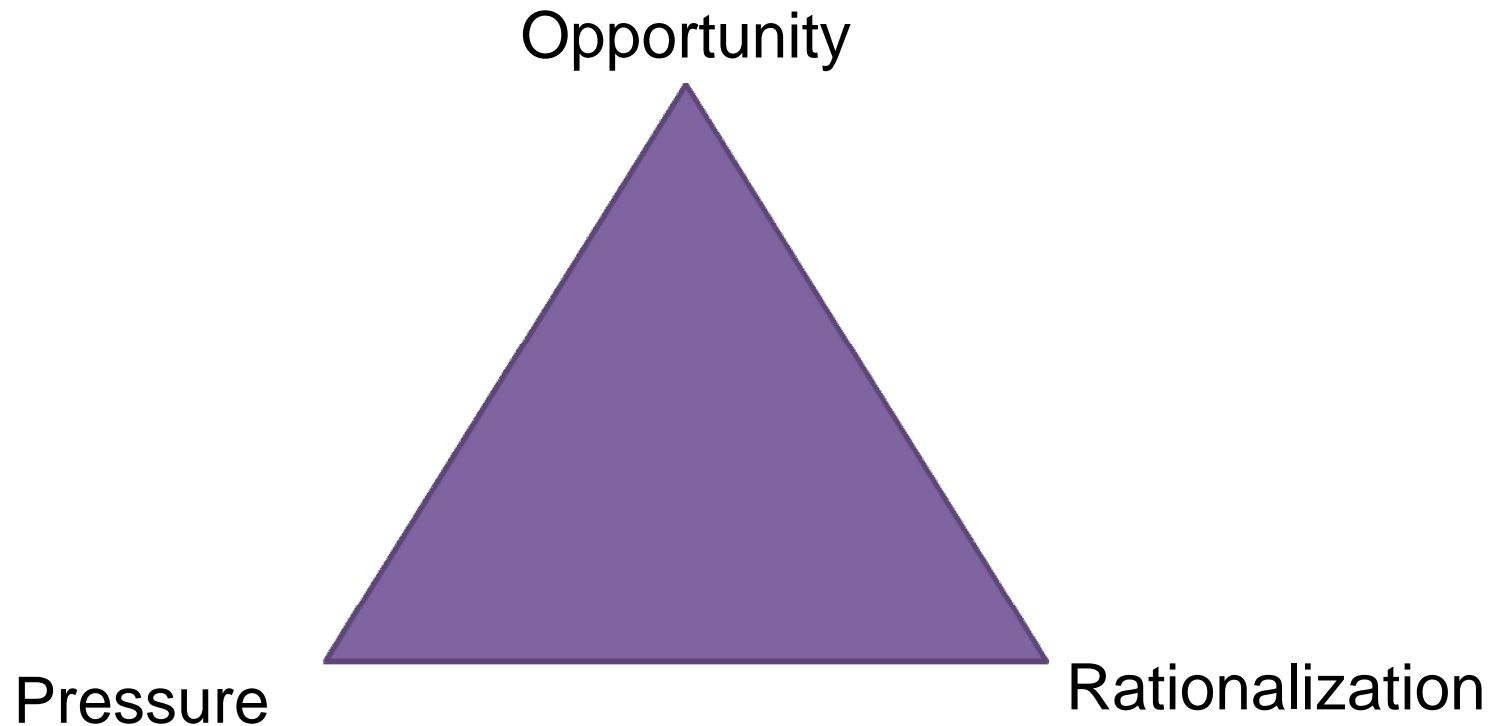
Corruption- a scheme in which a person uses his or her influence in a business transaction to obtain an unauthorized benefit contrary to that person's duty to his or her employer

Fraudulent statements – fabrication of an organization's financial statements to make the company appear more or less profitable

Why do People commit fraud



The Fraud Triangle



Financial Statement Fraud



Work Pressure

- ▶ Performance targets
- ▶ Poor financial performance
- ▶ Threat of job loss

Personal pressure:

- ▶ Extravagant Life style
- ▶ To meet society's expectation
- ▶ To cover errors
- ▶ Intellectual challenge
- ▶ Financial problems
- ▶ Drugs or gambling
- ▶ Greed
- ▶ Medical bills

Opportunity

- ▶ Weak organizational policies and procedures
- ▶ Poor organizational corporate governance

Rationalization

Is justifying a behavior
i.e. I stole

- ▶ To save a family member who was sick or in jail.
- ▶ To save my home, car, etc. from being auctioned by the bank
- ▶ To reward myself because the organization does not pay me enough.
- ▶ To take my children to school.

Financial Statement Fraud



*Financial Statement Fraud- deliberate misrepresentation of the financial condition of an enterprise accomplished through the intentional misstatement or omission of amounts or disclosures in the financial statement to deceive financial statement users- **ACFE definition.***

Financial Statement Fraud schemes



- “ Revenue/Accounts Receivable Frauds*
- “ Inventory/Cost of Goods Sold Frauds*
- “ Understating Liability/Expense Frauds*
- “ Overstating Assets Frauds*
- “ Overall Misrepresentation/ disclosures*
- “ Performance schemes (Procurement schemes, contractor schemes)*

Integrating Effective Risk Management into the Audit plan



Risk management based on COSO framework;

- *Set Objectives for the organization*
- *Analyze Potential risks of violations*
- *Develop a strategy to manage risks*

Integrating Effective Risk Management into the Audit plan

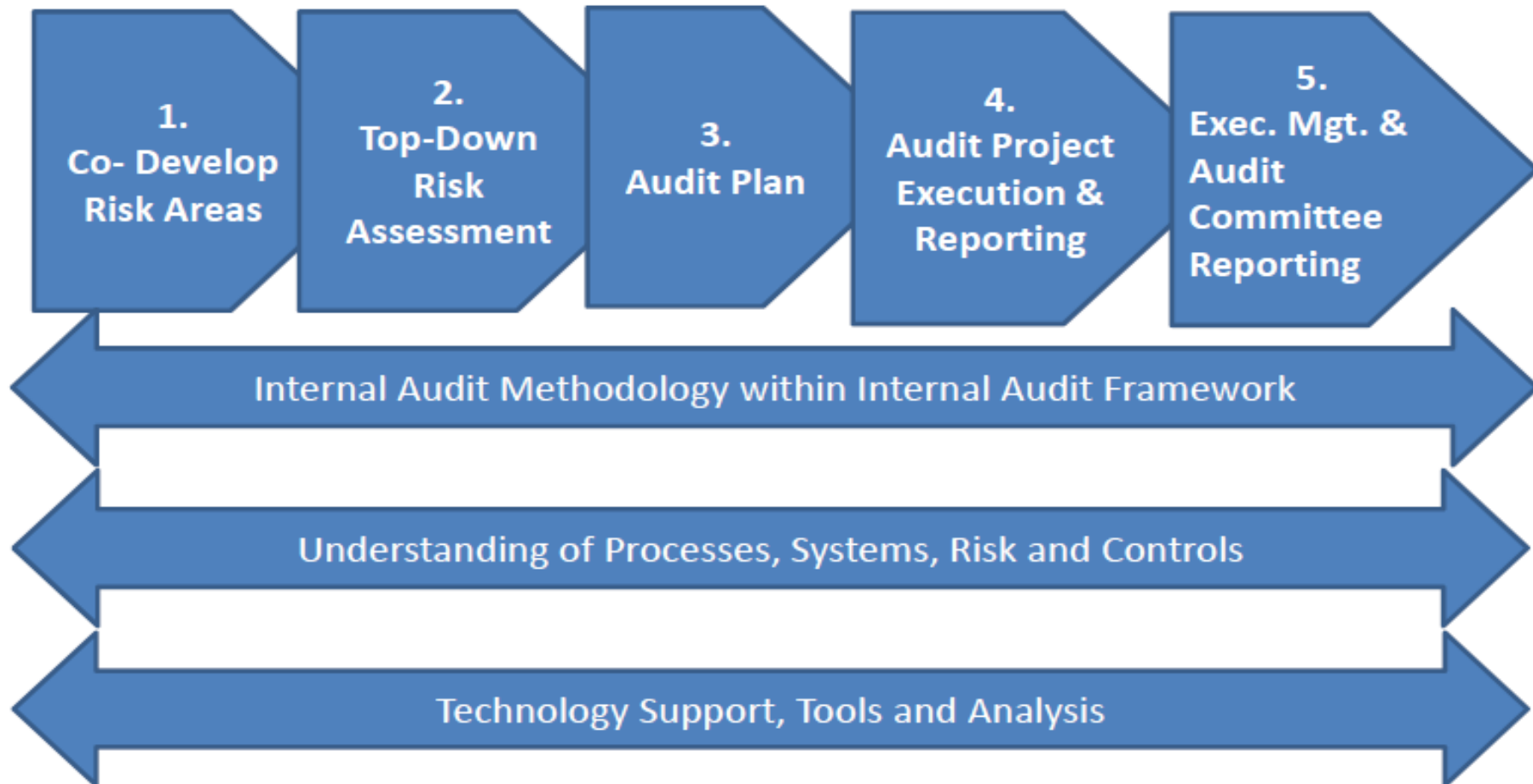


” Three Lines of Defense

” Risk & Risk Management

” Internal Controls

Integrating Effective Risk Management into the Audit plan



Executive Fraud-Related Schemes



- “ *Misstating Financial Statements*
- “ *Executive Loans and Corporate Looting*
- “ *Insider Trading*
- “ *IPO Favouritism*
- “ *CEO Retirement Perks*

Case studies- Financial Statement Fraud



- *Enron Energy- USA*
- *Imperial Bank- Kenya*
- *Chase Bank- Kenya*
- *The NYS Scandal*
- *The Anglo-leasing scandal*



Case study: Enron Energy



Role of Andersen- Enron Auditors

- ” Was paid \$52 million in 2000, the majority for non-audit related consulting services.*
- ” Failed to spot many of Enron’s losses*
- ” Should have assessed Enron management’s internal controls on derivatives trading—expressed approval of internal controls during 1998 through 2000*
- ” Kept a whole floor of auditors assigned at Enron year around*
- ” Enron was Andersen’s second largest client*
- ” Provided both external and internal audits*
- ” CFOs and controllers were former Andersen executives*
- ” Accused of document destruction—was criminally indicted*
- ” Went out of business*

Case study: Enron Energy



Why did Enron case happen?

- “ Individual and collective greed—company, its employees, analysts, auditors, bankers, rating agencies and investors—didn’t want to believe the company looked too good to be true*
- “ Atmosphere of market euphoria and corporate arrogance*
- “ High risk deals that went sour*
- “ Deceptive reporting practices—lack of transparency in reporting financial affairs*
- “ Unduly aggressive earnings targets and management bonuses based on meeting targets*

Incentives for financial statement Fraud

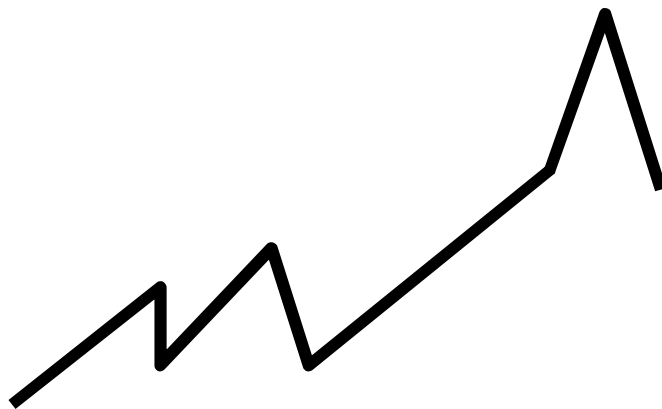


- “ Incentives to commit financial statement fraud are very strong.*
- “ Investors want decreased risk and high returns.*
- “ Risk is reduced when variability of earnings is decreased.*
- “ Rewards are increased when income continuously improves*

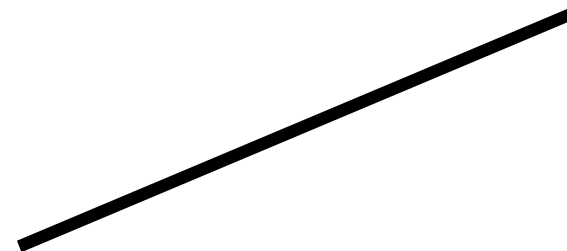
Incentives for financial statement Fraud



Firm A



Firm B



Which firm will have the higher stock price?

Lessons Learnt



Why so many financial statement frauds

- ” Good economy was masking many problems*
- ” Moral decay in society*
- ” Executive incentives*
- ” Corporate expectations—rewards for short-term behavior*
- ” Nature of accounting rules*
- ” Behavior of CPA firms*
- ” Greed by investment banks, commercial banks, and investors*
- ” Educator failures*

Way Forward



Will Financial Statement Frauds occur in the future?

YES:

- “ There has been an increasing number of financial statement fraud cases in the recent years*
- “ Incentives still exist*
- “ Corporates keep setting high targets for executives*

NO

- “ Governments have stepped in to regulate industries- Risk Based approaches(Basel Frameworks)*
- “ Requirement to have internal controls*
- “ Accounting Rules for accountants (mandatory audit partner rotation; Oversight Board, limitations on services, etc.)*

Interactive Session



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