

Types of Fraud, Detection and Mitigation

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Contents



Types of fraud, their modes of detection and mitigation

- *Contract and Procurement Fraud*
- *Asset Misappropriation*
- *Financial Statement fraud*

What is Fraud?



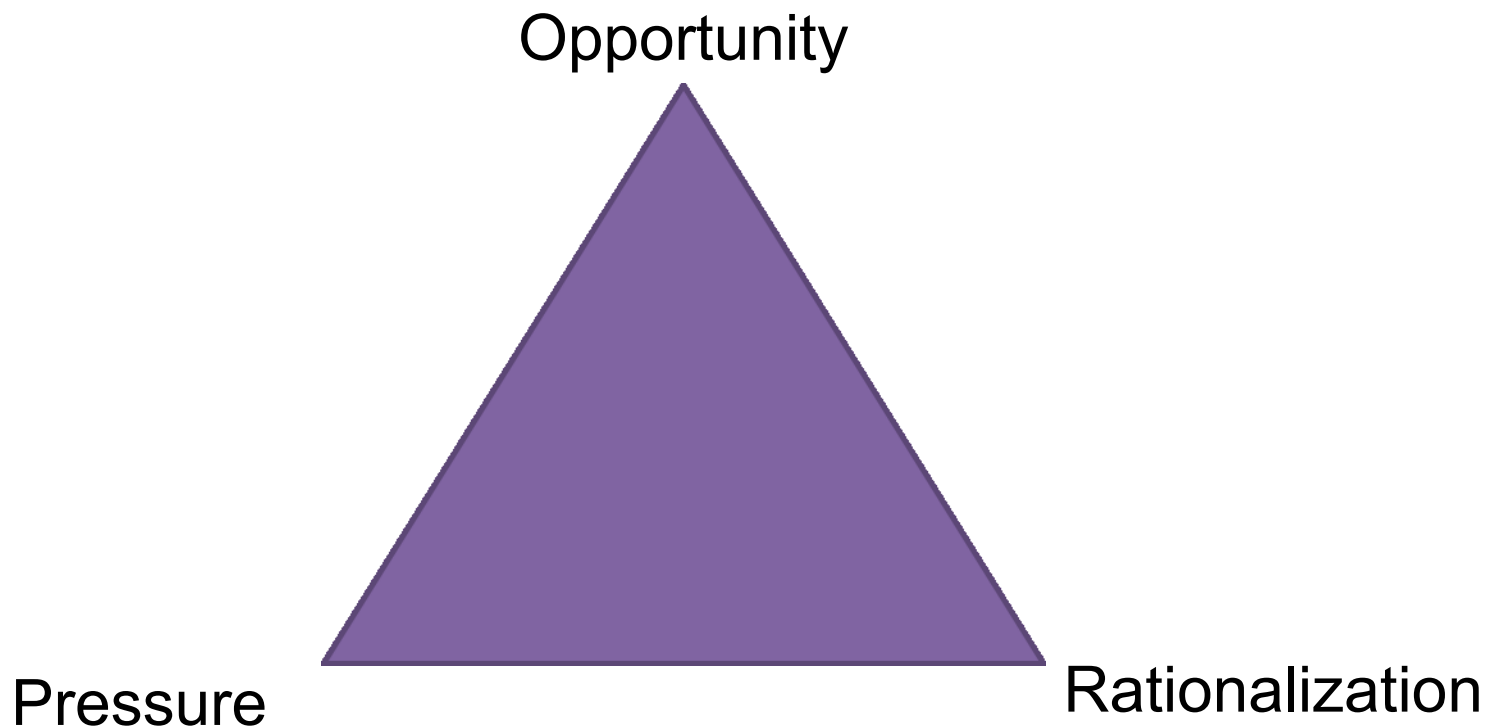
***Fraud** is an intentional deception made for personal gain in order to obtain unauthorized benefits (money, property, etc.)*

- *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*

Why do People commit fraud



The Fraud Triangle



Why do People commit 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.

Classifications of Fraud



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

Procurement Fraud- Unlawful manipulation of the procurement process to acquire goods or services to obtain an unfair advantage.

Classifications of Fraud

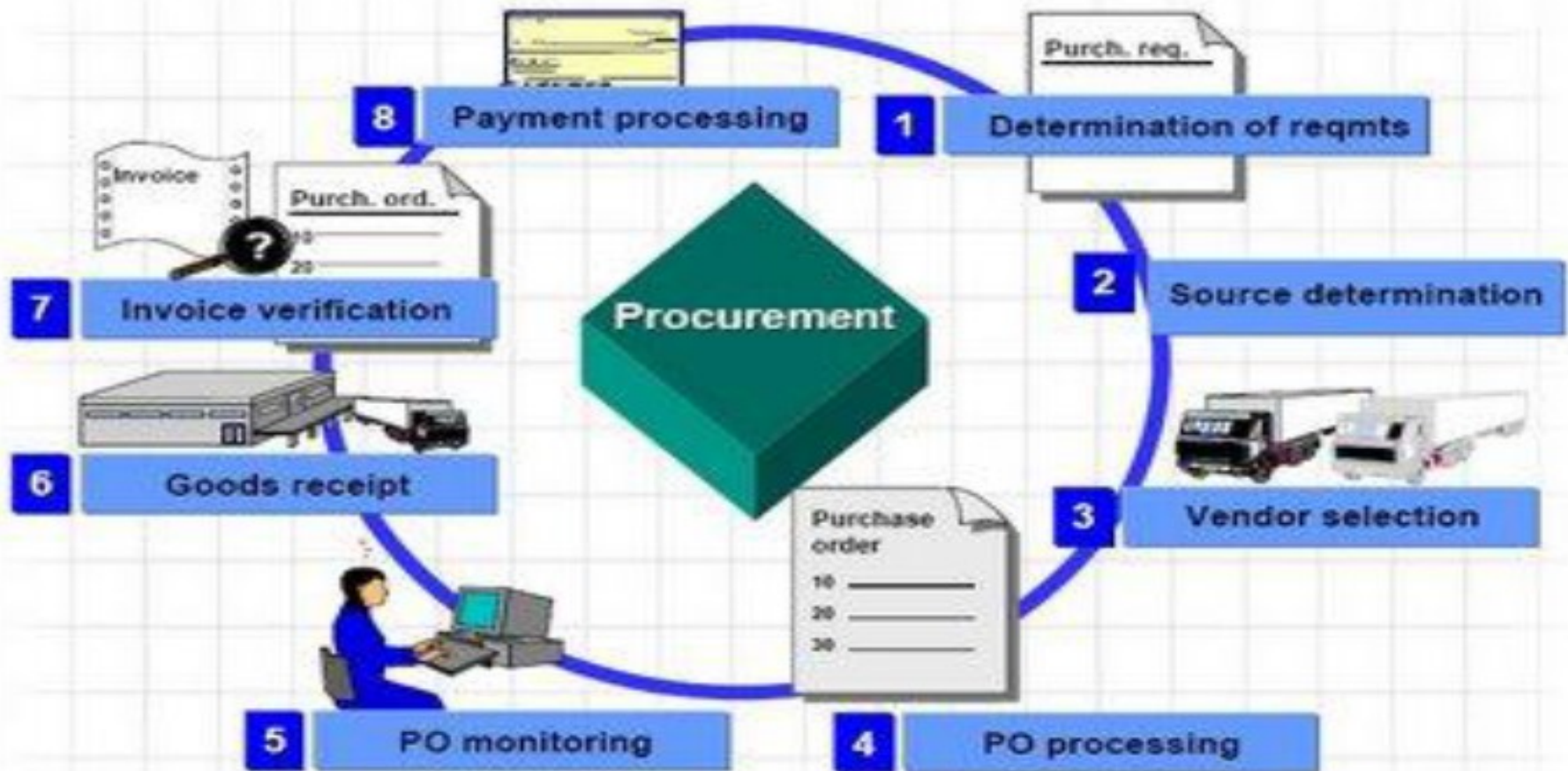


***Fraudulent statements** – fabrication of an organization's financial statements to make the company appear more or less profitable*

***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*

Contract and Procurement Fraud

The Ideal Procurement Cycle



Contract and Procurement Fraud



Procurement Process

- Contracting to acquire goods or services
- Often based on relationships
- Decisions to acquire made objectively and subjectively
- Purchases dictated by company policies and procedures
- Conflicts arise between operations and financial controls
- Process is often challenged by various work-arounds

Contract and Procurement Fraud



Common types of procurement fraud

- *Collusion between employees and vendors*
- *Vendors defrauding the company*
- *Collusion among vendors within an industry*
- *Employees defrauding their employers*

Contract and Procurement Fraud



Procurement Fraud Schemes

- Conflicts of interest
- Phantom vendor
- Split purchase orders/split orders
- Kickbacks
- Personal purchases
- Duplicate payments
- Defective products
- Product substitution
- Fictitious invoices
- Bribery
- Bid rigging

Asset Misappropriation Schemes



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

- *Cash receipts schemes*
- *Inventory and all other assets schemes*

Asset Missapprrpiation



Asset Misappropriations

Stealing Receipts

Employee Alone

Customer Alone

**Collusion
(together)**

**Stealing Assets
on Hand**

Employee Alone

**2+ Employees
Together**

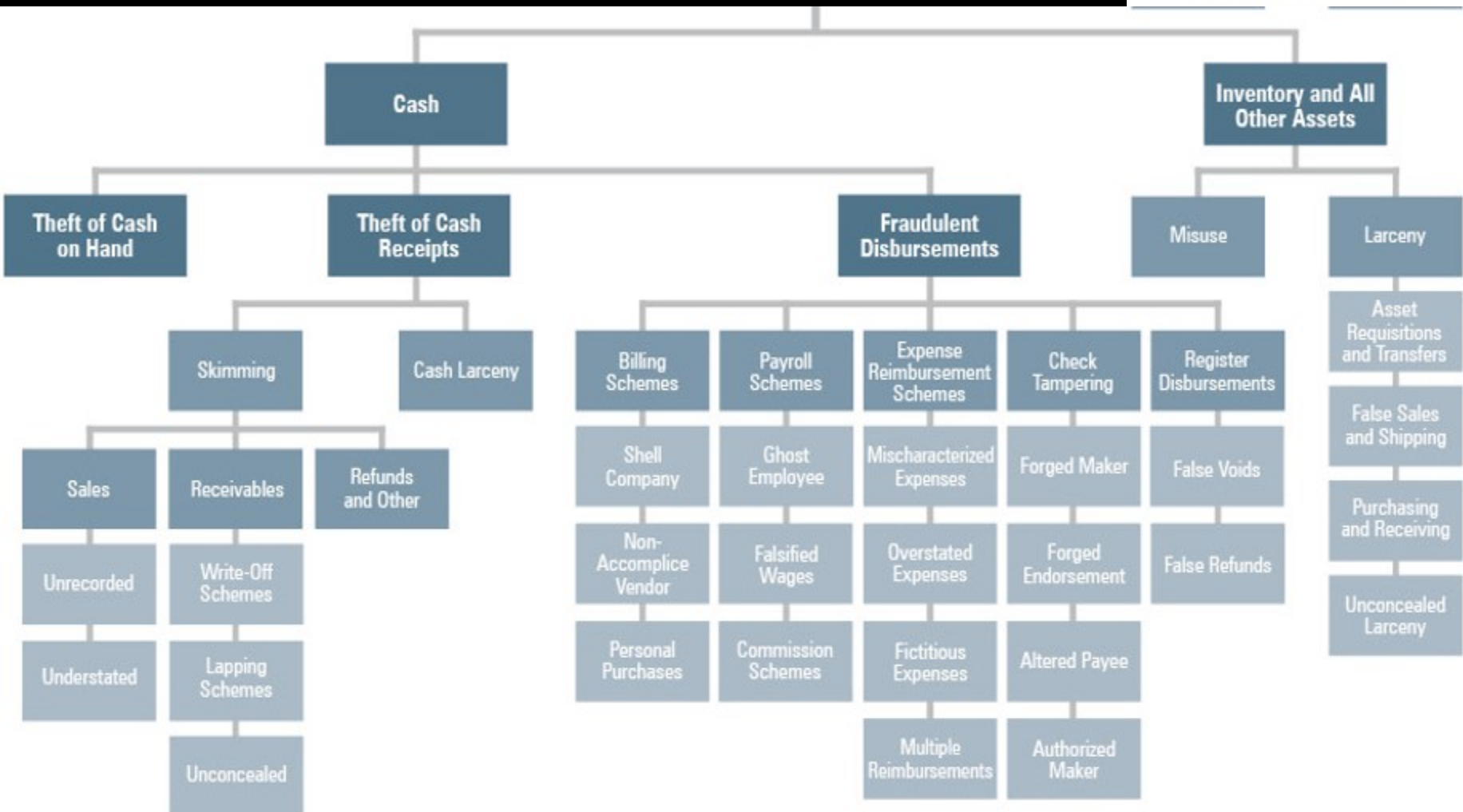
**Disbursement
Fraud**

**Employee
Alone**

Vendor Alone

**Collusion
(together)**

Asset Misappropriation Schemes



Controlling risks



- ❑ Organization are adopting the COSO risk management and control

frameworks to manage and control fraud risk.

- ❑ The three lines of defense framework play a key role in prevention and

detection of asset misappropriation fraud.

Sales and Accounts Receivables



Cash Receipts Schemes

Two types;

- a) Skimming – Cash not being recorded in the books of the organization (off-book fraud)*
- b) Larceny- perpetrated when cash has already been recorded in the books of the org*

Cash Larceny



How it is perpetrated:

- *Cash theft at cash collection points*
- *Transactions reversing.*
- *Register manipulation*
- *Altering cash counts*
- *Destroying cash register tapes.*
- *Deposit lapping.*
- *Deposit in transit.*

Detection of cash Larceny



- ❑ *Analysis of cash receipts*
- ❑ *Review and analysis of the cost of sales, cost of sales, returns and allowances*
- ❑ *Analysis all journal entries made to cash accounts on a periodic basis*

Controlling Cash Larceny



- ▶ *Enforcing Segregation of duties*
- ▶ *Assignment rotation and mandatory vacations*
- ▶ *Surprise cash counts and supervision*
- ▶ *Physical security of the cash-lockable drawers*

Fraud Risks in Cash Disbursement



How Cash reimbursement fraud is perpetrated.

- *Fictitious expenses*
- *Overstated expenses*
- *Multiple reimbursements*

Fraud Risks in Purchasing and Accounts Payable



Two types

1. *Billing Schemes*
2. *Cheque Tampering Schemes*

Fraud Risks in Purchasing and Accounts Payable



Billing Schemes

- *Invoicing via shell companies*
- *Invoicing via non-accomplice vendors*
- *Personal purchases with company funds*

Fraud Risks in Purchasing and Accounts Payable



Prevention of Billing Schemes

- *Training purchasing personnel on ethical standards*
- *Sufficient compensation for purchasing staff to reduce the motive and rationalization of fraud*
- *Proper documentation-pre-numbered and controlled purchase requisitions; purchase orders receiving reports; cheques*
- *Proper approvals-for vendor additions; Local Chart of Authority with limits*

Fraud Risks in Purchasing and Accounts Payable



Prevention of Billing Schemes

- *Segregation of duties-purchasing separate from payment function*
- *Invest in hotlines*
- *Enforce policies on competitive bidding*
- *Purchases and inventory levels should be reviewed for completeness and accuracy*
- *Credit card statements should be reviewed periodically for any irregularities*

Fraud Risks in Purchasing and Accounts Payable



Cheque Tampering Schemes

- *Forged maker*
- *Forged endorsements*
- *Altered payee*
- *Authorized maker*

Fraud Risks in Purchasing and Accounts Payable



Prevention of cheque Tampering Schemes

- *Banking controls*
- *Cheque preparation/ disbursement controls*
- *Cheque custody controls*
- *Physical tampering controls*

Fraud Risk in Payroll and HR



Payroll Schemes

- *Ghost workers*
- *Commission Schemes*
- *Falsified hours and hourly schemes*

Fraud Risk in Payroll and HR



Payroll schemes detection

- *Analysis of deductions from payroll*
- *Review of overtime for proper authorizations*
- *Random checks on customers to confirm sales for the commission paid*
- *Comparative analysis of commissions earned by salespersons*
- *Analysis of payee addresses and accounts*

Fraud Risk in Payroll and HR



Prevention of Payroll schemes

- *Segregation duties in payroll duties*
- *Monthly payroll reconciliation and management reviews.*
- *Outsourcing of payroll processing to a contractor*

Fraud risk in Physical Assets



Inventory and physical assets schemes

- *Theft of inventory, equipment and other assets*
- *Misuse of company assets*
- *Larceny*
- *Asset requisition and transfers*
- *Purchasing and receiving schemes*

Fraud risk in Physical Assets



How to detect physical assets fraud schemes

- *Review of perpetual inventory records*
- *Undertaking physical inventory counts*
- *Analytical review of cost of sales, sales, purchases and purchase prices*

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)*

Executive Fraud-Related Schemes



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

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*

Driver of financial Fraud



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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