Emerging Issues

Financial Statement Fraud

ANNUAL FORENSIC SEMINAR

MOMBASA

NASUMBA KIZITO KWATUKHA -

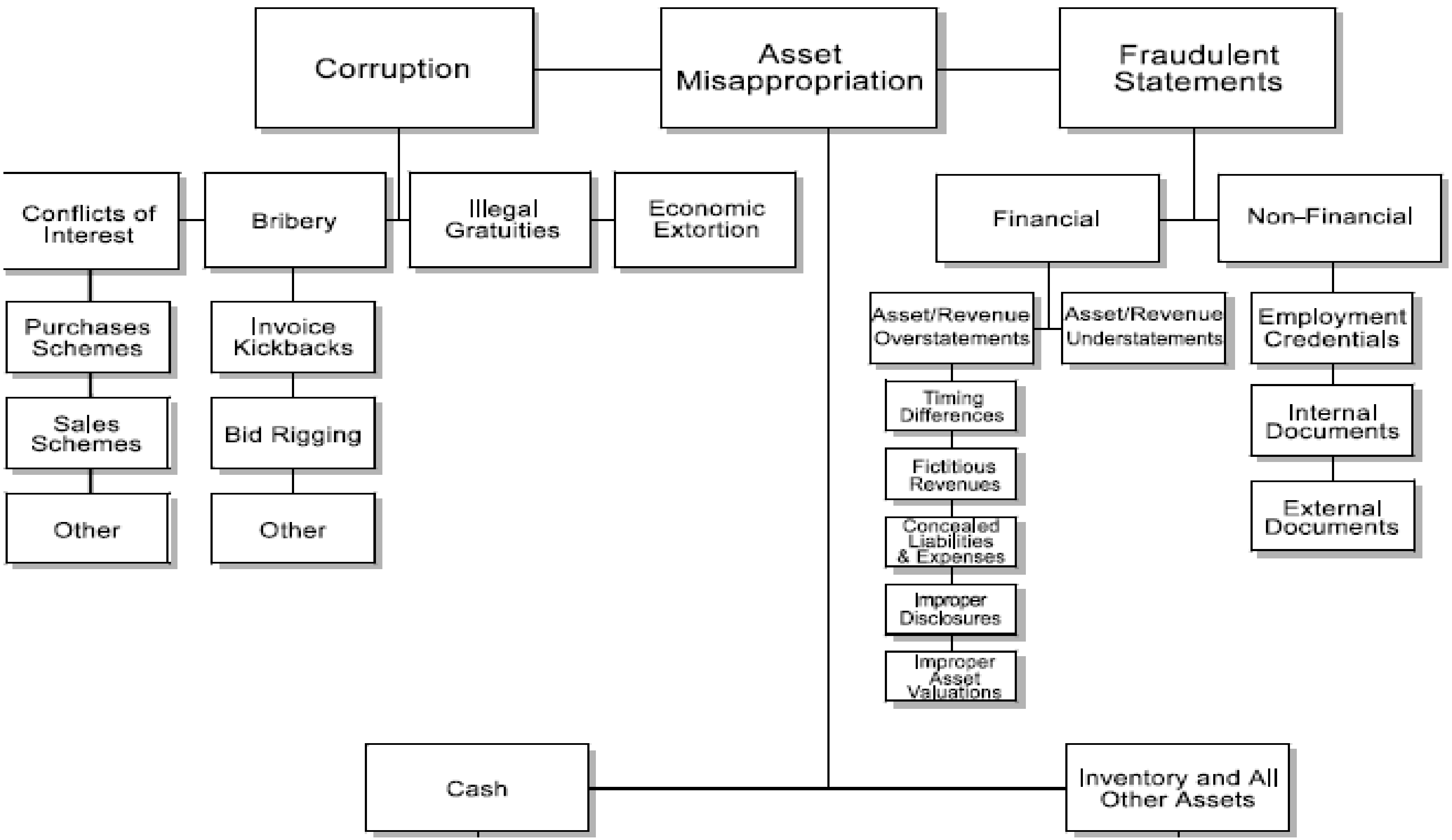
CPA,CIA,CISA,CISM,CISSP,CISI,CRMA,IIK

Executive Director - IARC
Strathmore University

Presentation agenda

- Introduction
- Financial statement fraud
- Q &A

Fraud Tree



Corruption
Asset Misappropriation
Fraudulent Statements
Conflicts of Interest
Bribery
Illegal Gratuities
Economic Extortion
Purchases Schemes
Sales Schemes
Other
Invoice Kickbacks
Bid Rigging
Other
Financial
Non-Financial
Asset/Revenue Overstatements
Asset/Revenue Understatements
Timing Differences
Fictitious Revenues
Concealed Liabilities & Expenses
Improper Disclosures
Improper Asset Valuations
Employment Credentials
Internal Documents
External Documents
Cash
Inventory and All Other Assets

Introduction

Financial statement frauds involves

Misrepresentation of the financial conditions of an enterprise through **intentional misstatement** or **omission** of amounts or **disclosures** in the financial statements to deceive financial statement users at the illegal gain of an Entity.

Uchumi; EAPC; Kenya Airways ; Mumias

Financial Statement Fraud

- Statement of Comprehensive Income-Sales and Expenses(Core Business)
- Statement of Financial Position – Assets and Liabilities
- Statement of Changes in Equity
- Statement of Cash flow
- Notes and Critical judgements

Fraud Triangle application

Motivation for financial fraud does not always involve direct personal financial gain.
The cause of financial statement fraud is;

- Situational pressure on the manager or company.
- Opportunity to commit fraud.
- Incapable Guardian

Has the highest median in terms of financial exposure

Situational Pressures

- Sudden decrease in revenue by a company or industry
- Financial pressures resulting from bonus plans that depend on short-term economic performance
- Unrealistic budget pressures particularly for short term results- Figures do not agree; Revenue and cash but not able to pay, Model of business- debtors specifically
- Common in revenue generating units

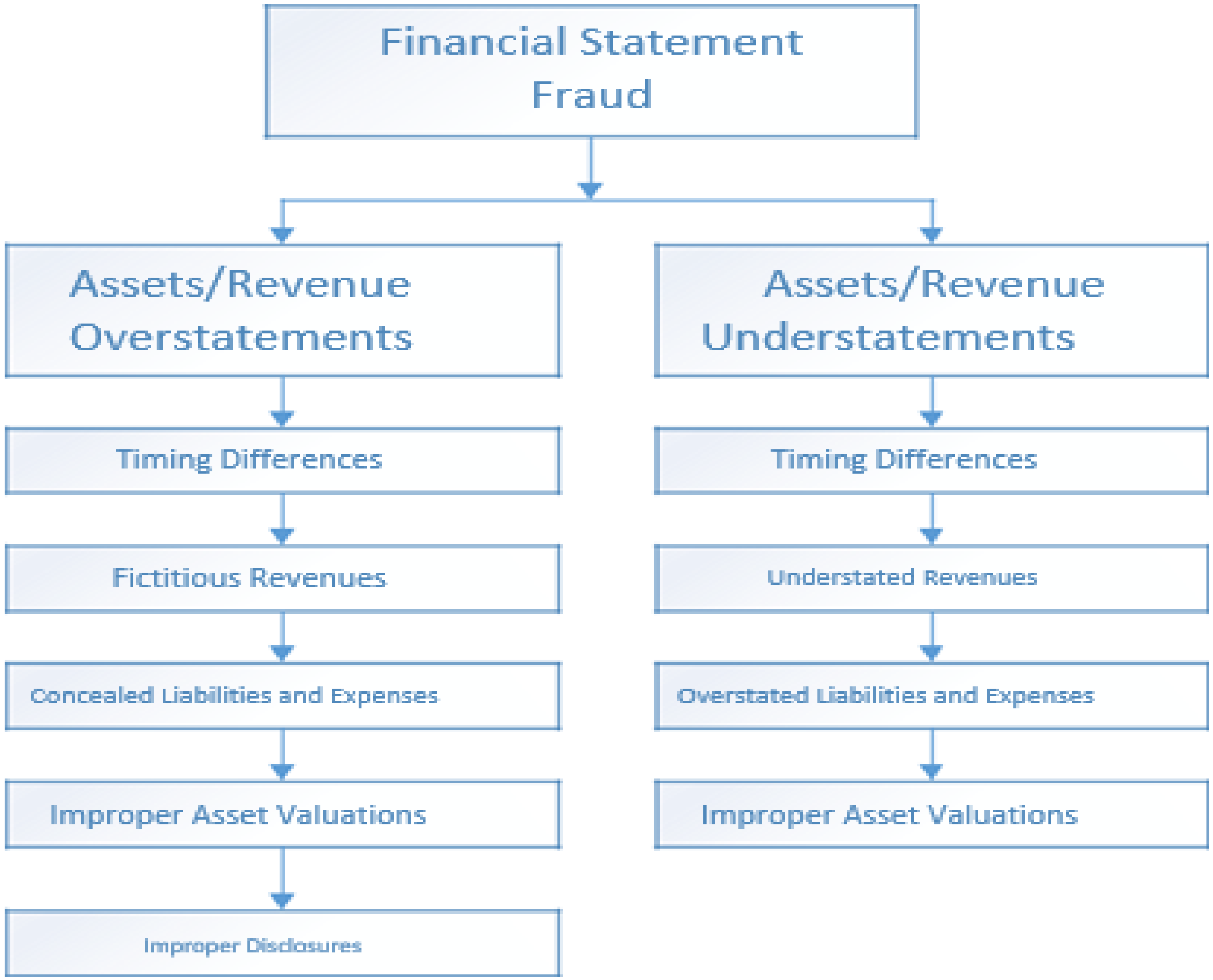
Opportunity

- Absence of a board of directors or audit committees.
- Financial estimates that require significant subjective judgment by management
- Technical Evaluations Specifically in intangible assets such as ICT costs and impairments

Why Financial Statement Fraud

- To quietly fix current problems – taxes; ladding
- To obtain or renew financing
- To obtain bonus pay linked to company performance
- To cover inability to generate cash flow
- To dispel negative market perceptions and show confidence.
- To receive higher purchase prices for acquisition
- To demonstrate compliance with financing covenants

Financial Statement Fraud



Financial Statement Fraud – Environment

- Check out the modules in the ERP and the access Levels
- Check the remote settings of your own PC including known network access ports
- Confirm who is responsible for adding; deleting and Changing tables
- Understand who creates debtors; suppliers in the ERP
- Understand who has access to the Access Directory and creates Users- Confirm you have the only account

Fictitious Revenues

- Recording of sales of goods that did not occur or shorten the period
- Increase in the Customer listing-similar patterns
- Sales with conditions. These are sales where ownership has not passed to the customer. They do not qualify for recording as revenue.
- Sales skimming- Cash transactions (Allocations in the
- Sales to any debit balance journals

Red Flags of Fictitious Revenues

- Customer Complaints book is very key
- Rapid growth or unusual profitability as compared to similar companies in the industry
- Significant transactions with related parties
- Unusual growth in debtors days analysis(rarely- they have to be a movement for analytical changes)

Timing Differences

- Recording of expenses or revenues in improper periods.
- Frequent changes in Accounting policy (restatement to distort tracking)
- Areas to look at on the above are;
  - Channel Stuffing- use of telesales
  - False Purchases
  - Recording expenses in the wrong period

Improper Asset Valuations

Improper asset valuation take the form of one of the following classifications;

Property and Investment – Experts are involved

Inventory valuations

Accounts receivable

Business combinations

Improper Asset Valuations

- Manipulation of the physical inventory count
- Inflation of the unit costs used to price out inventories
- Creation of fictitious inventory e.g. manipulated stock count sheets
- Reported large values of inventory in transit
- Fictitious Suppliers and Customer details

Improper Asset Valuations

- Fictitious accounts receivable, these are common with companies with financial problems or from managers who receive commissions on sales.
- Failure to write off bad debts and to make provisions for bad debts
- Skimming
- Journal to sales and cash
- Creation of Debtors with perfect details

Improper Asset Valuations

- Capitalizing non-current assets
- Understate fixed assets-common in Government entities
- Misclassifying assets-reporting fixed assets as current assets, for loan / liquidity purposes
- Failure to post invoices
- Creating fictitious debit notes This is the easiest scheme to perpetrate and the hardest for debtors to detect.

Detect Financial Statement Fraud

- Ratios
- Study of relationships

Q and A

- Nasumba Kizito Kwatukha-
- CPA,CIA,CISA,CISM,CISSP,CISI,CRMA,IIK
- Executive Director – IARC
- Strathmore University