



Forensic, Fraud and  
Internal Controls  
Workshop

# Facilitator



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# Outline



1. Fraudulent financial transactions
2. Signs of fraud in an organization
3. Potential fraud loopholes created by employees in organizations
4. The steps involved in conducting an internal investigation



# FS Fraud Statistics



- ❖ *According to the ACFE's 2020 Report to the Nations, financial statement fraud comprised 10% of the frauds reported in the study, with a median loss of \$954,000.*
- ❖ *Financial statement fraud schemes are the **least common** and **most costly***
- ❖ *Asset Misappropriation the schemes are most common and least costly*

# Fraudulent financial transactions



**Definition:** **Deliberate** misrepresentation of the financial condition of an enterprise accomplished through the intentional misstatement or omission of amounts or disclosures in the financial statements to deceive financial statement users.

## Financial Statement Fraud Schemes

1. Timing Differences
2. Fictitious Revenues
3. Concealed Liabilities and Expenses
4. Improper Asset valuation
5. Improper Disclosures



*"Daddy doesn't know any magic tricks.  
Daddy knows accounting tricks."*

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# Fraudulent financial transactions



## Drivers to Financial Statement Fraud

- ❖ To cover inability to generate cash flow
- ❖ To avoid negative market perceptions
- ❖ To obtain financing, or to obtain more favorable terms on existing financing
- ❖ To receive higher purchase prices for acquisitions





## Drivers to Financial Statement Fraud Cont...

- ❖ To encourage investment through the sale of stock
- ❖ To demonstrate increased earnings per share or partnership profits interest
- ❖ Increased dividend/distribution payouts
- ❖ To demonstrate compliance with financing covenants
- ❖ To meet company goals and objectives
- ❖ To receive performance-related bonuses

# Red Flags



## *What Red Flags Are Associated with Fictitious Revenues?*

1. An unusually large amount of long **overdue accounts receivable**
2. Outstanding accounts receivable from customers that are difficult or impossible to identify and contact
3. Rapid growth or unusual profitability, especially compared to that of other companies in the same industry
4. Recurring negative cash flows from operations or an inability to generate positive cash flows
5. Significant transactions with related parties or special purpose entities not in the ordinary course of business

# Red Flags



## *What Red Flags Are Associated with Fictitious Revenues?*

6. Unusual growth in the days' sales in receivables ratio (receivables/average daily sales)
7. A significant volume of sales to entities whose substance and ownership is not known
8. An unusual increase in sales by a minority of units within a company or in sales recorded by corporate

# Red Flags



## Red Flags Associated with Timing Differences

- ❖ Rapid growth or unusual profitability, especially compared to that of other companies in the same industry
- ❖ Recurring negative cash flows from operations or an inability to generate positive cash flows from operations while reporting earnings and earnings growth
- ❖ Significant, unusual, or highly complex transactions, especially those close to the period's end, that lead to difficult “substance over form” questions

# Red Flags



## Red Flags Associated with Timing Differences

- ❖ Unusual increase in gross margin or gross margin in excess of industry peers
- ❖ Unusual growth in the days' sales in receivables ratio (receivables/average daily sales)
- ❖ Unusual decline in the days' purchases in accounts payable ratio (accounts payable/average daily purchases)

# Signs of Fraud in an Organization



It is ineffective to instruct employees that they must help the organization fight fraud if they do not have some accompanying information about what to look for.

## *BEHAVIORAL RED FLAGS*

1. Living beyond their means
2. Financial difficulties
3. Control issues, unwilling to share duties
4. Unusually close relationship with vendor/customer
5. Wheeler-dealer attitude
6. Divorce/family problem
7. Unwilling to take vacation days

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# Potential fraud loopholes created by employees



1. Wrong Tone at the top
2. Staff override of controls
3. Staff collusion – SOD compromise
4. Failure to put in policies and procedures
5. Implementation of weak controls
6. Hiring and manipulation of incompetent staff
7. Staff Intimidation

# Steps involved in conducting Internal Investigation



## Establish Causes for Investigation:

1. Suspected use of controlled substances
2. Allegations of discrimination and/or harassment
3. Harm to property/theft
4. Misconduct
5. Safety concerns

# Steps involved in conducting Internal Investigation Cont ...



## Set Goals of the Investigation:

1. Did the behavior occur?
2. What is the appropriate discipline, if any?
3. How can we reduce damages/recover?
4. How can we limit the risk of liability in the future?
5. Can we prevent a repeat occurrence?
6. Can we set the right tone at the top?

# Steps involved in conducting Internal Investigation Cont ...



## Legal Pitfalls Associated with Investigations

1. Violation of Labor Agreement
2. Discrimination/Harassment Claims
3. Retaliation Claims
4. Negligent Hiring/Retention
5. False Imprisonment
6. Employee Privacy Concerns
7. Defamation/Libel
8. Poor chain of custody

# Steps involved in conducting Internal Investigation Cont ...



## The Steps:

1. Strategy formulation and team constitution
2. Identify Potential Witnesses
3. Identify Documents
4. Prepare Outline of Topics and Questions
5. Interview and Documents Review
6. Reporting and testifying

**NB: Move from general to specific.**



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# The End



*Thank you!*

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