



TYPES OF FRAUD AND RECOGNIZING FRAUD INDICATORS



CONTENTS -

1. Introduction to Frauds
2. Corruption
3. Asset Misappropriation
4. Financial Statements Fraud
5. *Conflict-of-Interest / Related Party Transaction ?*



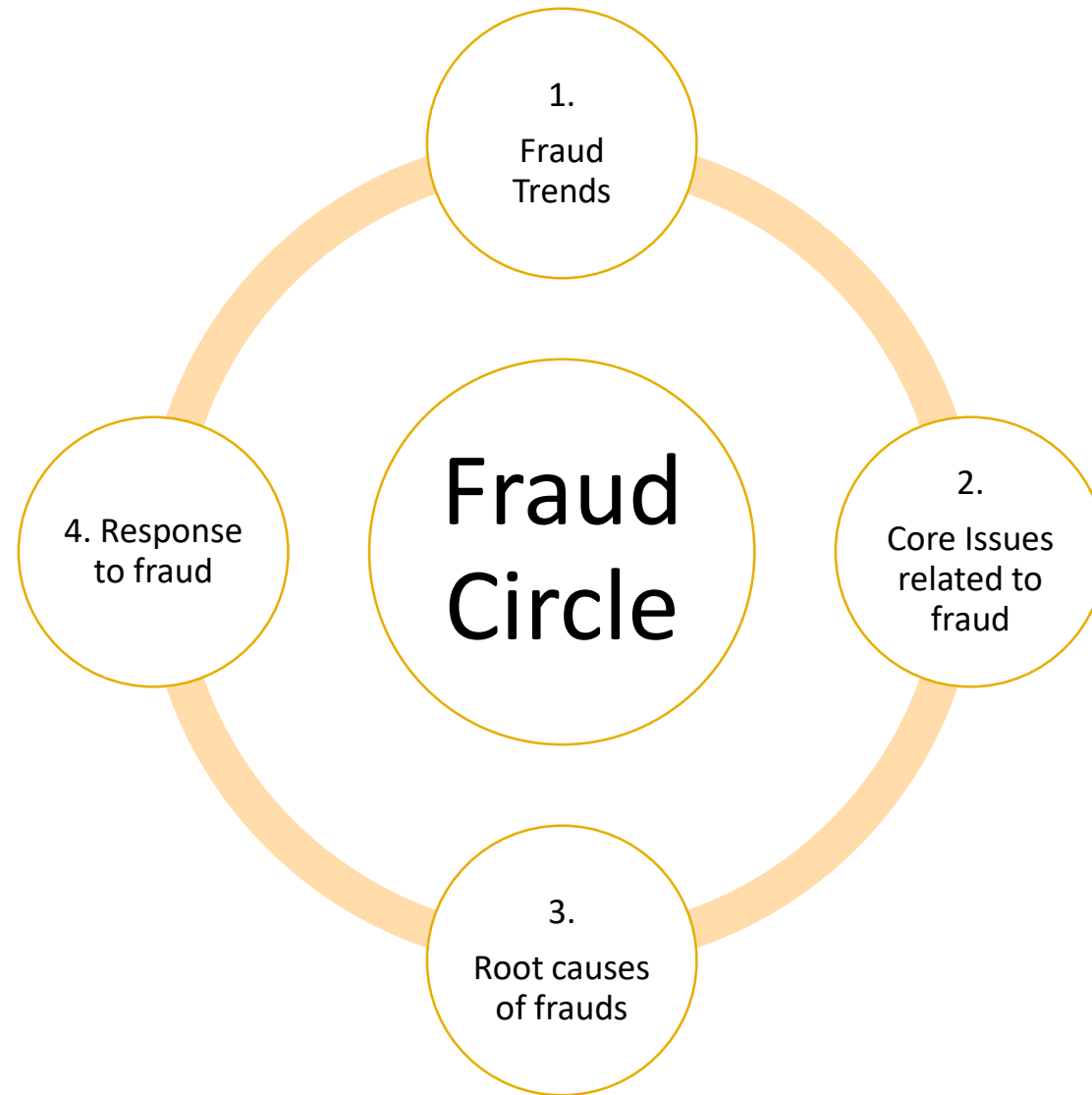
1. Introduction to Frauds

Why Do Frauds Happen ?

A fraud triangle is a tool used in forensic auditing that explains three interrelated elements that assist the commission of fraud –

- Pressure (motive),
- Opportunity (ability to carry out the fraud), and;
- Rationalization (justification of dishonest intentions)







FRAUD TRENDS

- Senior Management frauds & over rides - Fraud at its core, its all about leadership & governance
- Lender frauds - fund diversion & siphoning
- Investee frauds - fund diversions & siphoning
- Investor frauds - between business partners
- Misuse & Abuse
- Related party frauds - between business partners
- Procurement frauds & turnkey project frauds



Core Issues related to fraud

1

Round tripping and Ever-greening

2

Siphoning & Related Parties

3

Teeming & Lading

4

Overrides, Misuse & Abuse of Authority

5

Leadership & Governance

6

Empowerment v/s Centralization

7

Digital ease and experience v/s Cyber Governance

RESPONSES

Fraud risk context

- Eye of forensic in IA – A fraudster’s mindset & detection technologies

Whistleblower Engagement

- Anonymous calling, written complaints & interactions
- Protection to the WB in all situations

Misuse & abuse

- Business, market & commercial intelligence

Reversing the forensic cycle

- from
- reactive > detective > preventive
- to
- preventive > detective > reactive

Anti fraud Governance

- Integration of antifraud controls into IFC Framework and internal audit framework
- Fraud risk grading of internal audit missions
- Fraud risk integration into enterprise risk management framework
- Fraud risk integration into corporate governance policy framework & cyber security framework

Technology Assist

- Digital Forensics
- Forensic Data Analytics



ROOT CAUSES OF FRAUDS

1. Inadequate & Ineffective Internal Audit

- Technology Ineffectiveness
- Attention to details
- Eye of Forensic

2. Inadequate & Ineffective Internal Controls

- Technology ineffectiveness
- Attention to details
- Eye of Forensic

3. Culture health of organization

4. Missing 3rd and 4th eye

5. Size of growth, Scale & Complexity

6. Leadership and Governance tone

7. Conflict of Interest and Lack of Independence

TYPES OF FRAUD

The forensic accountant could be asked to investigate many different types of fraud. The three categories of frauds are –

- Corruption,
- Asset Misappropriation,
- Financial Statement Fraud, and;
- Conflict-of-Interest / Related Party Transaction ?

Yes, if not transparently disclosed and procedures not followed



Fraud and deceit are
anxious for your money.
Be informed and
prudent.





2. Corruption

1. CORRUPTION | DEFINITION

Bribery

Bribery means offering, giving, receiving, or soliciting of any item of value to influence the actions of an official, or other person, in charge of a public or legal duty *

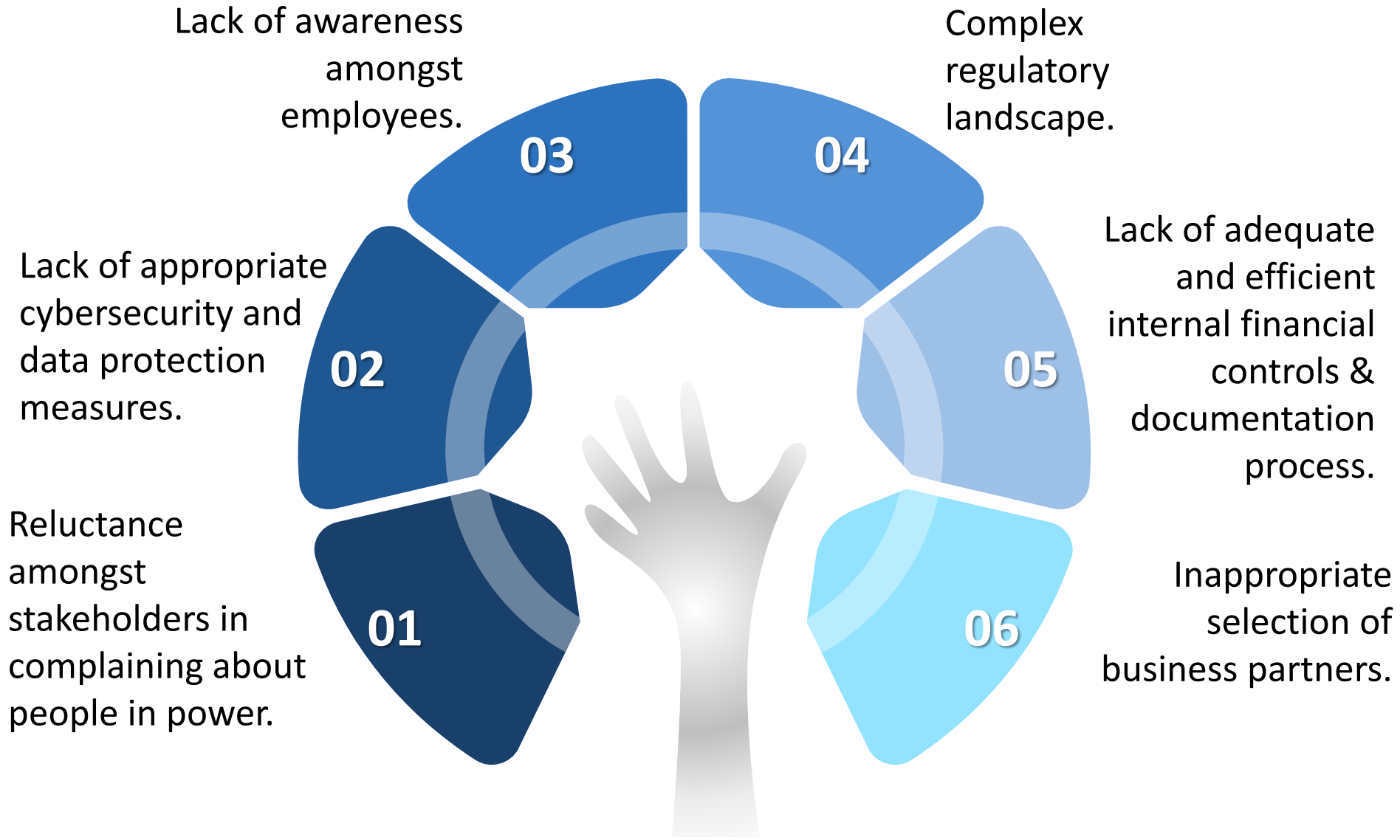


Corruption

Corruption is a form of dishonesty or criminal offense undertaken by a person or organization entrusted with a position of authority, to acquire illicit benefit or abuse power for one's private gain. It could be simplified as illegitimate use of public power to benefit a private interest

* Black's Law Dictionary

CHALLENGES IN FIGHTING BRIBERY & CORRUPTION



GLOBAL ACT | GLOBAL ANTI-CORRUPTION LANDSCAPE



India

Prevention of Corruption Act, 1988



Australia

Criminal Code Act, 1995



Hong Kong

Prevention of Bribery Ordinance



USA

Foreign Corrupt Practices Act, 1977



France

SAPIN II



Brazil

Brazilian Anti-Corruption Act



United Kingdom

The Bribery Act, 2010



South Africa

The Financial Intelligence
Centre Act, 2001



Singapore

Prevention of Corruption Act,
Chapter 241 of Singapore



A “covered” person / entity

- U.S. citizen, national, or resident.
- Corporation, partnership, association, joint-stock company, business trust, unincorporated organization, or sole proprietorship which has a principal place of business in the U.S.

With “corrupt” intent

- Benefit conferred or offered to induce government official to abuse or misuse his/her position or authority through action or inaction
- Quid pro quo generally assumed
- Gift/payment made with reasonable expectations of some official favour in return
- Quid pro quo need not be executed
- Official need not be able to deliver “quo” alone
- Government need not establish that defendant knew his/her conduct violated the FCPA

To “obtain or retain business”

- Payment made to obtain or retain business by:
 - ✓ Influencing any official act or decision
 - ✓ Inducing official to do or omit to do acts in violation of official duties
 - ✓ Securing any improper advantage
 - ✓ Inducing official to influence acts of government
- Need not relate to a specific business opportunity
- Bribes with any “business nexus” such as to reduce duties/taxes can violate FCPA

Must offer / give something of “Value”

- Cash and cash equivalent
- Extravagant hosted travel and non-monetary gifts
- Intangible benefits such as enhanced reputational value for the official or benefit conferred to favored cause or charity
- Benefit to third persons with connection to government officials (i.e. hiring the child of a government official)
- Includes offer or promise alone
- No de minimis exception if improper intent

To a “Foreign Official”

- Ministry and agency employees, Customs and tax officials
- Law enforcement and military
- But “foreign officials” can include people often not usually thought of as government officials
- Employees of companies or commercial enterprises that are owned or controlled by the state (e.g., government-owned bank, energy producer or distributor)
- Employees of universities which are owned by a government or receive public funding (e.g., public universities)



COMPARISON OF DIFFERENT ACTS |

Provision	FCPA	UKBA	SAPIN II	POCA
Bribery of Public Officials	✓ <input type="checkbox"/>	✓ <input type="checkbox"/>	✓ <input type="checkbox"/>	✓ <input type="checkbox"/>
Commercial bribery (Private to Private Bribery)	✗ <input type="checkbox"/>	✓ <input type="checkbox"/>	✓ <input type="checkbox"/>	✗ <input type="checkbox"/>
Receipt of a Bribe	✗ <input type="checkbox"/>	✓ <input type="checkbox"/>	✗ <input type="checkbox"/>	✓ <input type="checkbox"/>
Facilitation payments	✓ <input type="checkbox"/> (Only in some exceptional circumstances)	✗ <input type="checkbox"/>	✗ <input type="checkbox"/>	✗ <input type="checkbox"/>
Coverage	Covers US listed companies doing business in various parts of the world and foreign corporation doing business in US.	Covers UK companies as well as other foreign companies doing business in UK thereby having much more wider coverage.	Covers all companies and foreign companies operating in Spain.	Covers Indian companies as well as other foreign companies doing business in India
Penalties	Unlimited Fines, Prison	Unlimited Fines, Prison	Limited fines, Prison	Limited Fines, Prison

✓ <input type="checkbox"/>	Covered in the Act
✗ <input type="checkbox"/>	Not Covered in the Act

FOREIGN CORRUPT PRACTICES ACT, 1977 (FCPA) | Cases In India



Cognizant

The New Jersey-based technology company agreed to pay \$25 million to settle violations of the anti-bribery, internal accounting controls, and recordkeeping provisions.

Oracle

SEC charged the California-based computer technology company with violating FCPA by failing to prevent a subsidiary from secretly setting aside money off the company's books to make unauthorized payments to phony vendors in India.

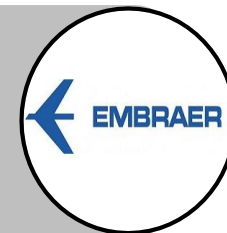


Beam Suntory Inc.

Agreed to pay more than \$8 million to resolve charges that its Indian subsidiary violated the FCPA by using third-party distributors to make illicit payments to increase sales orders, process licensing registrations, and acquire non-public data

Embraer S.A.

Approximately \$5.76 million was allegedly paid to an agent in India in connection with the sale of three highly specialized military aircraft for India's air force. The payments were falsely recorded in Embraer's books as part of a consulting agreement that wasn't legitimate



Cadbury Limited/Mondelez International

Agreed to pay a \$13 million penalty for FCPA violations occurring after Mondelez (Kraft Foods Inc.) acquired Cadbury and its subsidiaries in India that proceeded to make illicit payments to obtain government licenses & approvals for a chocolate factory.

Diageo

SEC charged one of the world's largest producers of premium alcoholic beverages for making \$2.7 million in improper payments to government officials in India



Anheuser-Busch InBev

The Belgium-based global brewery agreed to pay \$6 million to settle charges that it violated the FCPA by using third-party sales promoters to make improper payments to government officials in India and chilled a whistleblower who reported the misconduct.



2.

Ethical Dilemma



CASE STUDY 1

- ❖ Mr. Tandon is a senior manager at NEC Construction Ltd. He played a key role in winning a government tender worth 5 crore.
- ❖ The above win ensured Mr. Tandon met all his annual targets making him eligible for the variable bonus.
- ❖ A month after winning the project, the commissioner requested him to book a stay for him at J W Marriott for the weekend.
- ❖ He decided to book the rooms for him, however did not claim the expense from the firm.

Is the action of Mr. Tandon justified?

Not Justified

CASE STUDY 2

- ❖ Mr. Verma is an indirect tax manager in a manufacturing company. An officer of the excise commission invites him to his son's wedding.
- ❖ There are four excise cases of the company pending with the officer.
- ❖ He decides to buy a luxury watch for his son as a wedding gift.

Is his act of buying the luxury watch acceptable?

Not acceptable, all gifts given to government employee or their relative must be in compliance of company gift policy.





CASE STUDY 3

- ❖ Mr. Das is the manger at SNP Consultancy. He has won a large project for internal audit.
- ❖ The CFO of the client requests him to hire his son at SNP Consultancy.
- ❖ In order to keep good relations with the CFO of the client, he decide to offer his son a job at his firm.
- Is this act of Mr. Das justified?
No
- Would your answer change If the son was a qualified CA and there was a vacancy in the GRC department in the firm. Also, if the hiring was done through the proper interview procedures.?
Yes



CASE STUDY 4

- ❖ You are the auditor of Angel Capital and have good relations with the management of the company.
 - ❖ You also look after the taxation related matters for NutriPro Foods and are currently fighting a tax related case for them with an income tax officer.
 - ❖ The son of this official is the founder of a company and is in need of funds for his company.
 - ❖ You decide to introduce the management of Angel Capital with the Tax Officers son.
 - ❖ The Tax Officer relaxes the charges against your client and waves a few charges, for helping his son out.
- Is the above action justified?

No, In absence of quid pro quo the action would be justified since you are only introducing the parties.

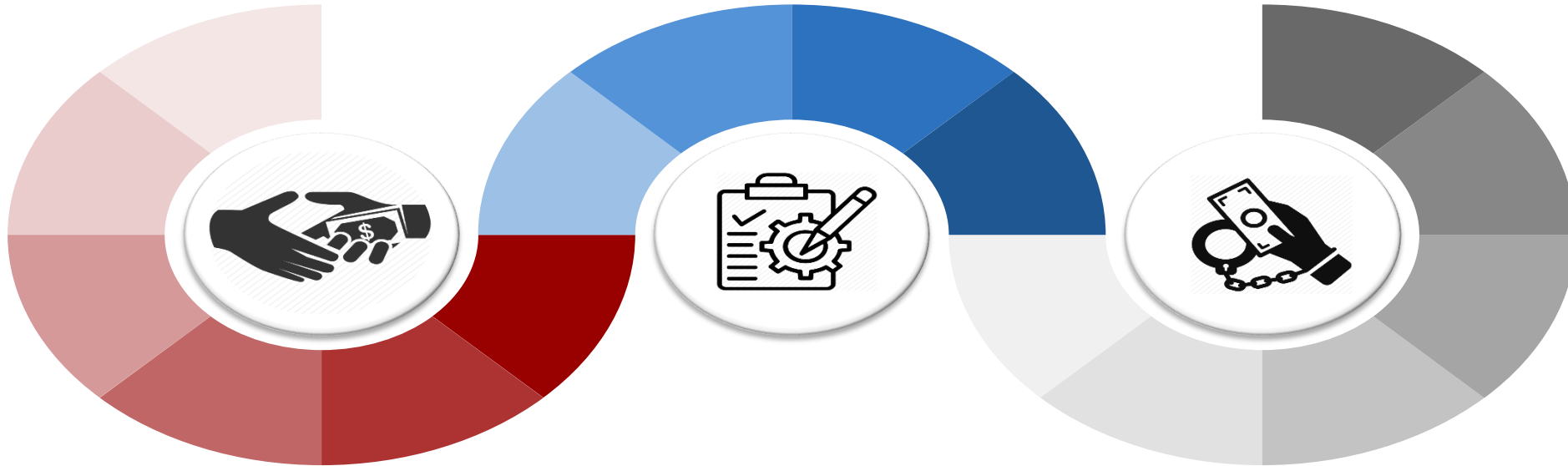


- ❖ You have gone with your team to Nigeria for one of your projects.
 - ❖ On your way from the airport to the client place one of the police officers demands a payment of 50,000 Nigerian Naira.
 - ❖ After returning from Nigeria you inform your seniors and the ethics department about the payment.
- Are your actions compliant with ABAC policy?

Yes

CASE STUDY (1/2)

Beam SUNTORY



Modus Operandi

- Beam Suntory used **third-party sales promoters** and distributors to make **illicit payments to government** employees.
- This was done in order to **increase sales** orders, process license and label registrations, and facilitate the distribution of Beam's distilled spirit products.

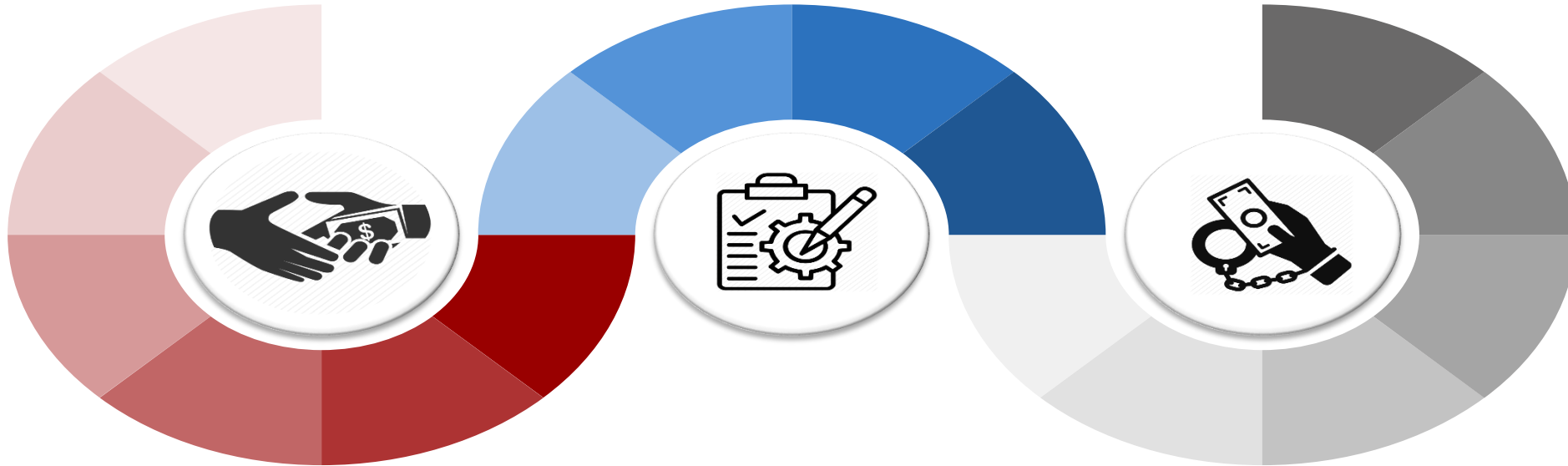
Accounting Lapses

- The Indian subsidiary **reimbursed the third-parties for the illegal payments** through fabricated or inflated invoices.
- It **falsely recorded the expenses** at the subsidiary level.
- The expenses were then consolidated into Beam's books and records.
- Beam also **failed to devise and maintain a sufficient system of internal accounting controls** as per the SEC.

Legal Repercussions

An **\$8.2 million penalty** consisting of disgorgement of \$5.26 million, prejudgment interest of about \$917,000, and a civil penalty of \$2 million.

CASE STUDY (2/2)



Modus Operandi

- Walmart paid bribes to several third-party intermediaries (TPIs) in these countries to get necessary approvals.
- In India, because of Walmart's **failure to implement sufficient internal accounting controls related to anti-corruption.**
- Through these operations Walmart was able to **retain TPI that made improper payments to government officials in order to obtain store operating permits and licenses.**
eg: Walmart was the funnelling of \$500,000 in a Brazilian company, to get construction related approvals.

Accounting Lapses

- Walmart falsely recorded improper payments in joint venture books.
- They used vague descriptions like **"misc fees," "miscellaneous," "professional fees," "incidental" and "government fee"**
- The company repeatedly **failed to take red flags seriously and delayed the implementation of appropriate internal accounting controls.**

Legal Repercussions

\$282 million (**approx. Rs 1,962 crore**) as fine for violating the Foreign Corrupt Practices Act (FCPA) in India, China, Mexico and Brazil.

COMMON GAPS |

Common gaps identified during an FCPA investigation leading to a multiplying effect on the penalties levied by investigating authorities

Third party dealings

1. No background checks conducted during on-boarding of vendors
2. Lack of oversight over dealings of third parties
3. Rational for payments to third parties not captured clearly

Accounting, Disclosures and Documentation

1. Expenses recorded under wrong accounting heads.
2. Lack of disclosures and documentation

Overall governance structure/environment

1. Ethics and Compliance policies not in place
2. Lack of awareness of the existing policies
3. Periodical trainings not conducted
4. Weak tone at the top to ensure compliance

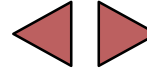
Internal Controls

1. Periodical pro-active reviews / Compliance testing against complaints not conducted
2. Mitigation steps not taken by management on identification of weak controls
3. Review of high risk transactions not done

ISSUES

SOLUTIONS

Entering into agreements with third parties at a higher rate of commission to enable generation of extra cash with the distributor/supply chain partner to bribe government officials.



- Perform due diligence/ background check while vendor on-boarding.
- Periodically verify the range of commission/charges paid is par with the industry standard.

Lack of documentation creating difficulty in identifying anonymous payments.



- Digitalize the process of storing documents
- Link bonuses of accounts team with document maintenance.

Illicit payments w.r.t liaison between with the government officials and companies for obtaining various licenses and approvals.



- Records must be maintained for every visit to government office to capture purpose of visit (with approval) and minutes of discussion.
- There should be periodic rotations of employees dealing with the officials.



3. Asset Misappropriation



ASSETS MISAPPROPRIATION - TYPES

By far the most common frauds are those involving asset misappropriation, and there are many different types of fraud which fall into this category.

- Before Assets are Recorded
 - Profit Skimming
 - Refund Theft
 - No Sale Transactions
 - Cash Larceny
- While Assets are being Retained
 - Pilfering Office Supplies
 - Taking Raw Materials
 - Using Equipment
 - Stealing Inventory
- As Assets are being Purchased
 - Payroll Scams
 - Fraudulent Expense Reimbursement
 - Billing Fraud



ASSETS MISAPPROPRIATION – SOME EXAMPLES OF FIXES

- Unauthorized Use of Equipment: Set strict policies and limits for employees and enforce them. Physically secure valuable equipment. Trust . . . but verify!
- Fake Sales / Purchases: It bears repeating that a formal policy of separation of duties, strict supervision, voucher accounting and all relevant internal controls must exist and be enforced at all times
- Inventory shrinkage: formal policy of separation of duties, strict supervision, voucher accounting, physical counts, reconciling shipment records with sales invoices

Fake Employees

At larger companies or companies that employ a remote workforce, fraudsters can utilize fake employees to swindle company funds. These ghost employees can either be entirely fake or real former employees who remain on the payroll after they have left the company.

How to Find It

Compare employment documentation with payroll records and isolate any employees with suspicious-looking or incomplete employment records.

How to Avoid It

Require regular all-employee gatherings and occasional face-to-face meetings to verify the existence of employees who would otherwise fly under the radar.



4. Financial Statement Fraud



Financial Statement Fraud

- It can include deliberate falsification of accounting records; omission of transactions– either revenue or expenses, non-disclosure of relevant details from the financial statements, balances or disclosures from the financial statements; or the misapplication of financial reporting standards.
- Companies get into this type of fraud to try to show the company’s financial performance as better than what it actually is.
- The goal of presenting fraudulent numbers may be to improve liquidity, ensure top management continue receiving bonuses, or to deal with pressure for market performance.

“Value of fraud is high – Instances are low”



SOME INTERNAL INDICATORS

- Delay in finalization of accounts;
- Frequent changes in accounting policies;
- Continuing losses;
- Over drawl of loans and advances;
- Higher cost per unit of production
- High amount of losses or wastage shown in books vs. norms;
- High investment in group companies;
- Profit not supported by increased cash availability.



An informed lender is simply less vulnerable to fraud and abuse.





Q & A

6. **Questions & Answers**



Thank You !

Kartik Radia
