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Professional Accountants

Strengthening the Capacity of Professional Accountants and their organizations in financial management.

[UNDERSTANDING FRAUD]

What should you know about FRAUD….

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FRAUD

I. Nature of Fraud

Fraud refers to:

* An intentional act or an intentional omission,

* Involving deception,

* Involving misrepresentation,

* Involving trickery,

* For the purpose of taking away property,

* From rightful owner,

* Without his knowledge,

* Without his consent

Fraud also refers to:

* Falsifying financial information,

* To mislead users of financial statements.

II. Legal Concepts of Fraud

Fraud has legal implications. Committing fraud may involve a crime or violation of the laws of the country, which is punishable by law.

Legal term used for fraud:

Theft- committed by a person to take the personal property of another without the owner's consent.

Robbery-committed by a person to take the personal property of another without the owner's consent, using violence or force.

Swindle-to get money or property from another under false presents or fraud.

Embezzle-to steal money or property entrusted to one's care.

III. Forms of Fraud

Category 1: Fraud involving theft, abstraction or diversion of company's assets in one form or another by officers or employees.

Examples

1. Fraud involves cash disbursement: Ex. expenses are paid twice, expense account are " Padded" (10 to 100 or 20 to 200). Personal expenses are charged to the organization.

2. Fraud involves payroll: Ex. Employee resigned are still kept in the payroll, rate of salary is overstated, and payment is made for overtime not performed.

3. Fraud involves inventory, supplies and material: Ex. Excessive purchasing of supplies and materials some of which are taken for personal use, the distribution list is more than actual number of beneficiaries.

4. Fraud involves fixed assets or equipment: Ex. Vehicles are used for personal purpose without authority, cash from sale of scrap are pocketed and not reported, bids for construction projects are given to " favored" the company in consideration of " commission" or " gift".

5. Fraud involves receivables (loan) and collections: Ex: loan receivable is not recorded in the book, collections are not issued with official receipts, collections received are not immediately submitted or deposited to the bank.

Category 2: Fraud involves falsification of financial statements for the purpose of misleading and deceiving users of the reports.

1. To influence creditors (banks) to grant loan to the company, financial statements are falsified to show a favorable financial position: Ex. Personal assets of the owner are reported as assets of the company, account payable or liabilities are not recorded, report more income and lesser expense.

2. To induce investors to invest to the company: Ex. Report high income and show high profit.

3. To avoid payment of taxes: Ex: report low income and show low profit.

IV. Factors Contributing to Fraud

1. Convertibility of assets: Assets which are easy to get like cash or jewelry, cars… which are easy to convert to cash are more likely to be misappropriated.

2. Degree of independent control over assets: A person who has a single and independent control over the asset contributes to the temptation to commit fraud.

3. Possibility of collusion: Operational situations may make it possible for two persons to agree to commit fraud. Ex. the buyer and supplier agreed to set a higher price, with the buyer getting something out of the negotiation at the expense of the company.

4. Quality of procedural implementation: Well-designed procedures are not properly complied with. In some cases, particular procedures may be done merely as a routine and done without care. Employees may be tempted to take advantage of this laxity (being careless). Ex. Supervisor is happy to sign on the routine document without care.

5. The verification of accountabilities: Accountabilities (ie. cash, inventories) are not verified (by cash count or physical verification) over a long period of time may lead to fraud.

V. Auditor Responsibility for Fraud

The following arguments will explain the auditor's interest and responsibility for fraud.

1. Nature of regular audit: An ordinary audit or examination is not primarily or specifically designed to disclose misappropriation or similar irregularities, although their discovery may result. The auditor, however, should not assume an attitude of indifference (showing no concern) to the possibilities of fraud.

2. Nature of special (fraud) audit: If the audit will attempt to discover all fraud and similar irregularities, he would have to extend his work to the point where the cost of audit would be prohibitive (excessive). Even then, this will not give an assurance that types of fraud will be detected because items such as unrecorded transactions, collusion or forgeries may not necessarily be detected.

3. Element of surprise in audit:

4. Failure to comply with GAAS: The responsibility of the auditor for failure to detect fraud arises only when such failure clearly results from the failure of the auditor to comply with generally accepted auditing standard (GAAS). An examination made in accordance with the audit standards gives considerations to the possibility of the existence of fraud.

5. Audit procedure is inadequate, professional due care: The auditor may be negligent when the fraud is widespread and the audit procedures performed are inadequate and professional due care is not exercised.

VI. Fraud Investigation

There are no finite rules or techniques for the discovery of fraud. Fraud is usually discovered as a result of certain irregular or questionable items, which arouse the suspicion of and were followed up by the auditor in the course of his examination. The auditor must therefore be alert to certain matters that may indicate the existence of irregularities.

Some of the possible of indicators of fraud are:

1. Refusal of officers or employees to cooperate in an audit.

2. Inadequate, inaccurate, and poorly kept records.

3. Lack of adequate internal control.

4. Inadequate supporting documentary evidence for transactions

5. Records, which can't be produced or located despite several requests.

6. Refusal by officers or employees to permit to confirm loans receivable, payables…

7. Over anxiety on the part of officers or employees to assist the auditor or hinder (to stop) or delay the examination.

8. Information that the officer or employee is living beyond his income capacity.

9. Many long outstanding cash advances/loans.

10. Refusal by officers or employees to take vacation or leaves.