

Controls for preventing Frauds and Corruption (including IT techniques)

महालेखाकार, ओडिशा

ACCOUNTANT GENERAL

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Background

- ❖ *Have frauds started haunting us?*
 - ❖ *In Oman?*
 - ❖ *In India?*
- ❖ *What causes fraud and corruption?*
 - ❖ *Mindsets?*
 - ❖ *System weaknesses?*
- ❖ *Can we prevent frauds?*
 - ❖ *Lessons learnt from a real case*
 - ❖ *Through controls set up*
 - ❖ *Through audit processes?*
- ❖ *How can technology help? –*

Some recently reported frauds in Oman -1

➤ January 15, 2014 – Gulf news

- **The judge at the Court of First Instance in Muscat sentenced Al Hinaï, from whose house the authorities had confiscated 873,000 Rials in cash, to three years in jail and ordered him to pay a fine of 600,000 Rials (Dh5.70 million). He was banned from holding public office for 20 years.**
- **The court also sentenced Mohammad Ali, who reportedly holds about 20 per cent stakes in Galfar Engineering, to three years in jail and Naushad to two years in jail. The outgoing Galfar managing director, who had maintained his innocence throughout the trial that began in November, was also ordered to pay 600,000 Rials in fines.**

Key message :- Tenders in PDO not clean.....



Some recently reported frauds in Oman -2

➤ May 11, 2013 – Muscat Daily

- **American and German authorities have announced the arrest of nine people in connection with a US\$45mn card heist by an international ring of hackers that involved hacking and withdrawing money from prepaid cards issued by Bank Muscat and the National Bank of Ras al Khaimah (Rakbank).**
- **The cash withdrawals were made through ATMs in 24 countries including the US, Germany, Japan, Russia, Romania, Egypt, Colombia, Britain, Sri Lanka and Canada.**

Key message :- Bank Muscat cards abused.....



Some recently reported frauds in Oman -3

➤ 31 Jan 2014 – Notification on Shell Oman website

- **There have been recent incidents that have occurred with organisations falsely pretending to recruit on behalf of Shell or by people claiming to work for, or be affiliated to, Shell.**
- **Please note that these communications are fraudulent. They do not originate from Shell nor are they associated with Shell's recruitment process.**
- **Salient points of such communications are that they come from non-Shell e-mail addresses (e.g. from a yahoo.com address); the use of English is poor; at some stage, money is requested**

Key message :- Recruitment promises to cheat.....



Some frauds reported by SAI India - 1

- Audit report Punjab 2006
 - *Irregular grant of sales tax exemption to two firms resulted in loss to government exchequer (Rs.10.1 mn)*
 - *Sales tax exemption was irregularly granted to two firms which had applied after the due date, exemption was stated to be granted on the advice of head of office*

Key message :- Authority abused.....



Some frauds reported by SAI India - 2

- Audit report Andhra Pradesh 2007
 - *Payment for telecast of advertisement was made by the health department, without ensuring that the advertisements were actually telecast (Rs.125.6 mn)*
 - *In a test check of records of the health directorate, audit noticed that 31 spots claimed to have been telecast by a company were actually shown on a channel not specified in contract and the certificates of telecast were fake*

Key message :- Falsification of records to cheat....



Some frauds reported by SAI India - 3

- Audit report Chattisgadh 2005 –
 - **Fraudulent payment on the activity of physical verification of saw mills (Rs. 22.9 mn) involved the following.**
 - **Sanction of expenditure by the CF beyond his delegated powers and without budgetary provision and administrative jurisdiction**
 - **Unauthorised expenditure booked under wrong head thus concealing the same**
 - **Mismatch of signatures on payment rolls**
 - **Only a handful people purportedly completed large number of inspections simultaneously**

Key message :- Reports manipulated to cheat.....



What causes fraud and corruption?

- **Fraud & corruption may co-exist in certain ways**
 - *Conflict of interest situation*
 - *Non existent company whose invoice is presented by an official involved in purchase process*
 - *Excess purchases with a view to divert for personal use*
 - *Split purchases to evade competitive bidding in exchange of favours*
 - *Tax or duty evasion through false representation involving negligence of Govt. official*
 - *Extortion*
 - *Nepotism*



Causes of fraud and corruption - 2

■ **Individual mentality -**

- *Economic – financial gain – needs surpassing compensation packages*
- *Greed*
- *Prestige or recognition – I matter, I can help*
- *Moral superiority – Westerners can do no wrong, so its ok if they are paid more*



Causes of fraud and corruption - 3

■ **System weaknesses -**

- *Insensitive management that judges employees on short term results*
- *Vague policies, inadequate internal control & accountability, history of abuse*
- *Low compliance of regulatory requirement, high turnover of employees, lack of transparency in reward systems*
- *Rationalization of actions that ends justify the means, either at the individual level or at the level of organization, the external perpetrator/accomplice might argue that corruption is a cost of doing business*



Understanding a typical fraud

- **Stamp Duty scam –**
 - **A case of an overconfident entity**
 - **A sharp mischievous person played havoc with the system**
 - **Revenues lost went unnoticed for years**
 - **Even audit initially thought this was “not likely on the scale alleged”**
- *.... Many important lessons learnt*
- *.....including amending the law itself*



Can we prevent frauds? - strong internal controls

- ❖ ***COSO (Committee of Sponsoring Organisations in US) study findings***
 - ❖ *Typical fraudulent financial reporting involved*
 - ❖ *overstatement of revenues and assets*
 - ❖ *premature or fictitious recording of revenues*
 - ❖ *understatement of allowances for receivables*
 - ❖ *overstatement of tangible assets*
 - ❖ *recording of non-existent assets*
 - ❖ *Most frauds committed in smaller corporations (\$100 million assets)*



Can we prevent frauds? - strong internal controls

- ❖ ***COSO (Committee of Sponsoring Organisations in US) study findings***
 - ❖ *Frequent involvement of top senior executives*
 - ❖ *Boards of Directors of these companies dominated by insiders*
 - ❖ *Few audit committees*
 - ❖ *Companies were experiencing net losses before frauds were committed*
- ❖ ***Key messages -Significant lack of internal controls***
- ❖ ***Controls overridden by management***



Can we prevent frauds? Scope and coverage of internal controls

- ❖ *Control environment*
- ❖ *Authority delegation*
- ❖ *Allocation of responsibilities- authorization, custody and recording*
- ❖ *Management's philosophy & operating style*
- ❖ *Internal controls , including internal audit, personnel policies*



Can we prevent frauds? Audit procedure in evaluation

- ❖ *Carry out a preliminary evaluation through trial testing of a few transactions*
- ❖ *Study of documentation in regard to controls for overall objectives and to prevent errors/omissions*
 - ❖ *Compliance tests*
 - ❖ *When control procedures are found to exist*
 - ❖ *Random checking of records to ascertain compliance procedures as per manual/flow-chart*
 - ❖ *Intended to provide evidence in regard to existence, effectiveness and continuity*



Can we prevent fraud?

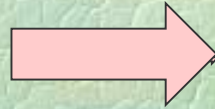
Extent of testing by external auditors

- ❖ *Depends on the degree of independence of internal audit*
- ❖ *Quality of personnel*
- ❖ *Scope and extent of testing by internal audit*
- ❖ *Availability of documented work of internal audit*
- ❖ *Compliance by management to internal audit reports*
- ❖ *Above factors may increase or reduce extent of testing*

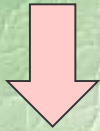


Risk assessment and internal control

Internal controls



Risk analysis



determines audit procedures



expression of audit opinion



Risk assessment and internal control (Contd.)

❖ *Efficient and effective audit approach is determined by:*

❖ *Risk assessment of audited entity having regard to:*

❖ *Past record of entity*

❖ *Management's experience*

❖ *Internal controls*

❖ *Business environment*

*To prevent under-auditing in high-risk and over-auditing
in low-risk situations*



Preventing frauds – using Information technology

- ❖ *Internet transactions have recently raised big concerns, with some research showing that internet transaction fraud is 12 times higher than in-store fraud.*
- ❖ *To prevent them we need to use technology. Some possibilities:-*
- ❖ *Data preprocessing techniques for detection, validation, error correction, and filling up of missing or incorrect data.*
- ❖ *Calculation of various statistical parameters such as averages,, performance metrics, probability distributions, and so on.*
- ❖ *Models and probability distributions of various business activities either in terms of various parameters or probability distributions.*
- ❖ *Time-series analysis of time-dependent data.*
- ❖ *Clustering and classification to find patterns / associations among groups of data.*



Preventing frauds – using Information technology - 2

- ❖ *Data mining to classify, cluster, and segment the data and automatically find associations and rules in the data that may signify interesting patterns, including those related to fraud.*
- ❖ *Expert systems to encode expertise for detecting fraud in the form of rules.*
- ❖ *Pattern recognition to detect approximate classes, clusters, or patterns of suspicious behaviour either automatically (unsupervised) or to match given inputs.*
- ❖ *Machine learning techniques to automatically identify characteristics of fraud.*
- ❖ *Neural networks that can learn suspicious patterns from samples and used later to detect them.*



Thank you.

