



FRAUD

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DEFINITION AND CLASSIFICATION

- Definition: Act or course of deception, an intentional concealment, omission, or distortion of truth, to gain unlawful or unfair advantage
- Classification of Fraud:
 - Asset Misappropriation
 - Financial statement fraud
 - Corruption

ASSET MISAPPROPRIATION

- Definition: Employee steals or missuses the organization resources (anything where you misrepresent asset in order to profit off of it)
- Examples:
 - Stealing assets through fake records
 - Giving discount to others unnecessarily

FINANCIAL STATEMENT FRAUD

- Definition: Intentional misstatement or omission(error) of material in organization's financial reports
- Nature:
 - Usually done to appear to have more or report loss; for income smoothing
 - Usually done by high ranking executive
 - Fictitious revenues

CORRUPTION

- Definition: misuse of influence; using authority to get something to which they are not entitled
- Examples:
 - Someone of high authority using their trusted position to attain something they're not entitled to. Or vice versa someone bribing a person of high authority for his means

FRAUD TRIANGLE

■ Pressure

→ Financial or emotional force pushing toward fraud Ex. Gambling, Drug Addiction, Greed, Extra-marital affairs, Ashamed of seeming incompetent (need respect)

■ Opportunity

→ Ability to execute plan without being caught
Ex. Lack of Internal Control or Internal Control Weakness (ICW), Seeing dishonest behavior of others

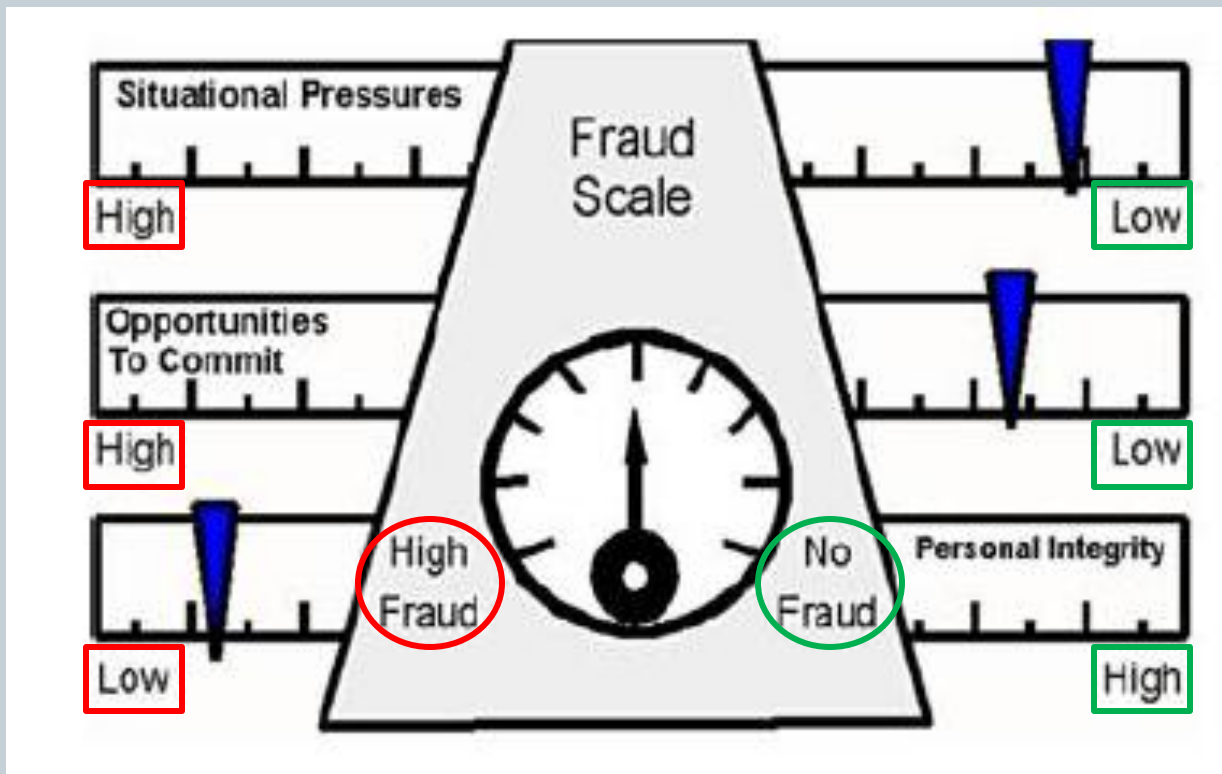
■ Rationalization/Justification

→ Personal justification of dishonest actions
Ex. Feeling that employers take advantage from them



Note: Fraud Diamond = + Competence (Skilled and Smart)
Fraud Pentagon = + Competence and Arrogance (Big Ego and Bullying Attitude)

FRAUD SCALE



4 PATHWAYS TO COMMIT FRAUD

■ Crisis Responders

→ Pressure = Gambling, Drug Addiction

■ Opportunity Takers

→ Internal Control Weakness (ICW)

■ Opportunity Seekers

→ Internal Control Weakness (ICW) + Competitive

■ Deviance Seekers

→ Competitive, Egocentric, Arrogant, Reckless, Neurotic personality

POTENTIAL FRAUD INDICATORS

- Suddenly start spending lavishly
- Increasingly secretive
- Severe personal financial losses, addiction to drugs, alcohol or gambling
- Overrides of controls by management or officers
- Irregular or poorly explained management activities
- Consistently exceeding goals/objectives regardless of changing business conditions
- Delays in providing requested information
- Significant or unusual changes in customers or suppliers
- Lack of documentation or normal approval
- Customer complaints about delivery
- Conveying dissatisfaction with the job to fellow employees
- Rarely take vacations or sick leave

FRAUD & IPPF

Attribute Standards

- **1210.A2** Internal auditors must have sufficient knowledge to evaluate the risk of fraud..., but are not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud.
- **1220.A1** Internal auditors must exercise due professional care by considering the: ...Probability of fraud...

FRAUD & IPPF

Performance Standards

- 2060 The Chief Audit Executive (CAE) must report periodically to senior management and the board on...including fraud risk...
- 2120.A2 The internal audit activity must evaluate the potential for the occurrence of fraud and how the organization manages fraud risk.
- 2210.A2 Internal auditors must consider the probability of ...fraud...when developing the engagement objectives.