

Financial Statement Fraud

Kurt Ramin, MBA, CFE, CPA, CEBS

August 03, 2020, 8 p.m. Dubai time



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Kurt Ramin is the Director of KPR Associates, with offices in Düsseldorf and Dubai. Mr. Ramin is a former Partner with PricewaterhouseCoopers (**PwC**), New York, Director of the IFRS Foundation in London, and Treasurer of the International Union for Conservation of Nature (**IUCN**), Switzerland. He served as a member of the EU Commission's High-Level Expert Group on Intangibles.

Mr. Ramin was involved in introducing International Financial Reporting Standards (**IFRS**) and **XBRL** to more than 70 countries.

Earlier in his career and before he joined PwC, he worked in key financial and operating positions in the United States and Germany (Dow Corning, Beiersdorf ("NIVEA"), and others).

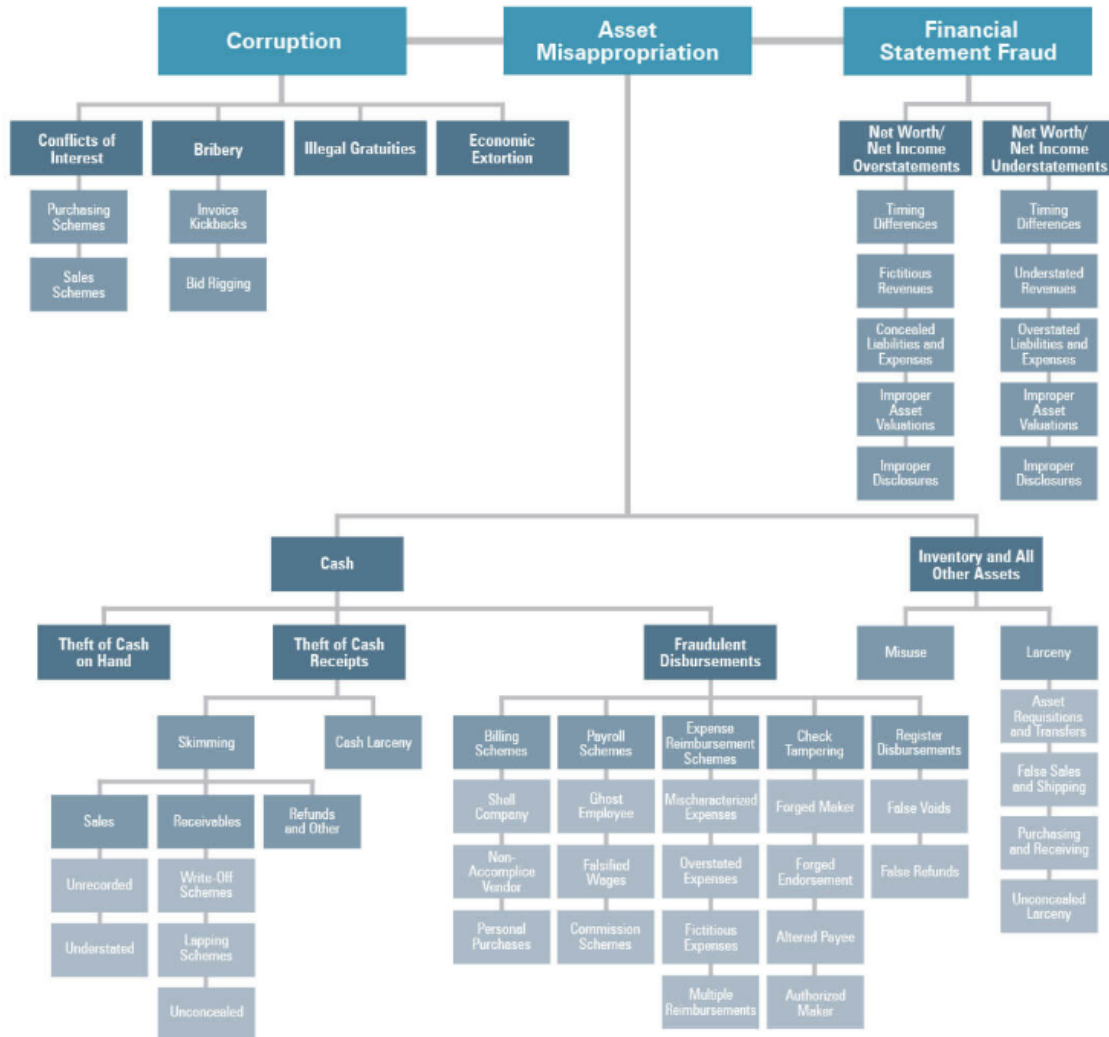
Mr. Ramin is Chair of ACFE's Global Higher Education Committee (elected in 2020) and is an **ACFE** authorized trainer for Germany preparing applicants for the exam to become a Certified Fraud Examiner (CFE). He is currently teaching "Corporate Fraud Management" at the University of Applied Sciences in Cologne.

Financial Statement Fraud - Agenda

- Fraud Tree, Fraud Triangle - Report to the Nations
- Fraud Cases and Capital Markets
- Financial Reporting Standards
- Major Types of Financial Statement Fraud
- Fraud Prevention, Deterrence, and Disclosure
- Non-Financial Disclosure and „Reporting Fraud“
- Summary

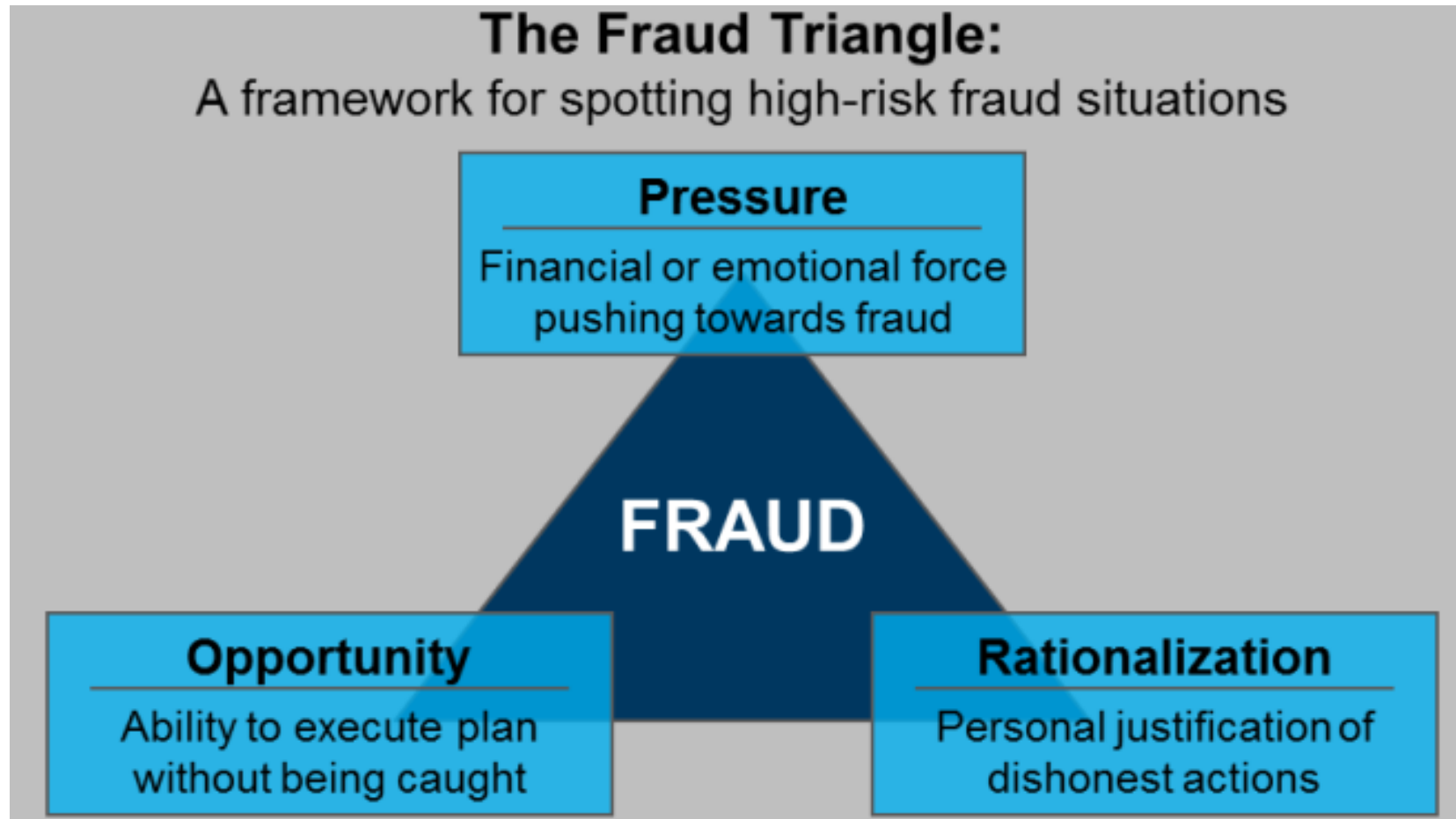
THE FRAUD TREE

OCCUPATIONAL FRAUD AND ABUSE CLASSIFICATION SYSTEM



Financial Statement Fraud





The *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.

REPORT TO THE NATIONS®

2020 GLOBAL STUDY ON OCCUPATIONAL FRAUD AND ABUSE



**FINANCIAL STATEMENT
FRAUD SCHEMES** are the
least common and most costly

10%
OF CASES

\$954,000
median loss

MORE THAN HALF of all occupational
frauds came from these four departments:

-  **OPERATIONS 15%**
-  **ACCOUNTING 14%**
-  **EXECUTIVE/UPPER
MANAGEMENT 12%**
-  **SALES 11%**

Indirect effect

	Cases	25th percentile	Median (50th)	75th percentile	Mean*
All cases	2,448	\$29,000	\$125,000	\$605,000	\$1,509,000
Schemes					
Asset misappropriation	1,639	\$21,000	\$100,000	\$500,000	\$1,199,000
Billing	306	\$20,000	\$100,000	\$407,000	\$842,000
Noncash	305	\$10,000	\$78,000	\$500,000	\$1,138,000
Expense reimbursements	193	\$6,000	\$33,000	\$140,000	\$202,000
Skimming	16	\$1,000	\$47,000	\$23,000	\$361,000
Cash on hand	15	\$1,000	\$26,000	\$95,000	\$104,000
Check and payment tampering	14	\$4,000	\$40,000	\$100,000	\$98,000
Cash larceny	106	\$13,000	\$83,000	\$305,000	\$1,000,000
Payroll	105	\$16,000	\$62,000	\$238,000	\$367,000
Register disbursements	27	\$7,000	\$20,000	\$65,000	\$85,000
Corruption	789	\$34,000	\$200,000	\$1,100,000	\$3,039,000
Financial statement fraud	186	\$140,000	\$954,000	\$5,000,000	\$8,693,000
Detection method					
Tip	869	\$30,000	\$145,000	\$750,000	\$1,486,000
Internal audit	291	\$14,000	\$100,000	\$350,000	\$1,115,000
Management review	240	\$26,000	\$100,000	\$570,000	\$1,316,000
By accident	103	\$50,000	\$200,000	\$600,000	\$613,000
Account reconciliation	86	\$17,000	\$81,000	\$325,000	\$485,000
External audit	80	\$39,000	\$150,000	\$972,000	\$2,397,000
Document examination	71	\$32,000	\$101,000	\$500,000	\$1,357,000
Surveillance/monitoring	56	\$10,000	\$44,000	\$300,000	\$955,000
Notified by law enforcement	48	\$197,000	\$900,000	\$9,750,000	\$5,206,000
IT controls	33	\$9,000	\$80,000	\$1,255,000	\$1,133,000
Confession	23	\$100,000	\$225,000	\$3,000,000	\$3,826,000

ACFE Report to the Nations

Fraud in Financial Statements

Just
8 % of cases

Median Loss:

**\$ 1
Million**

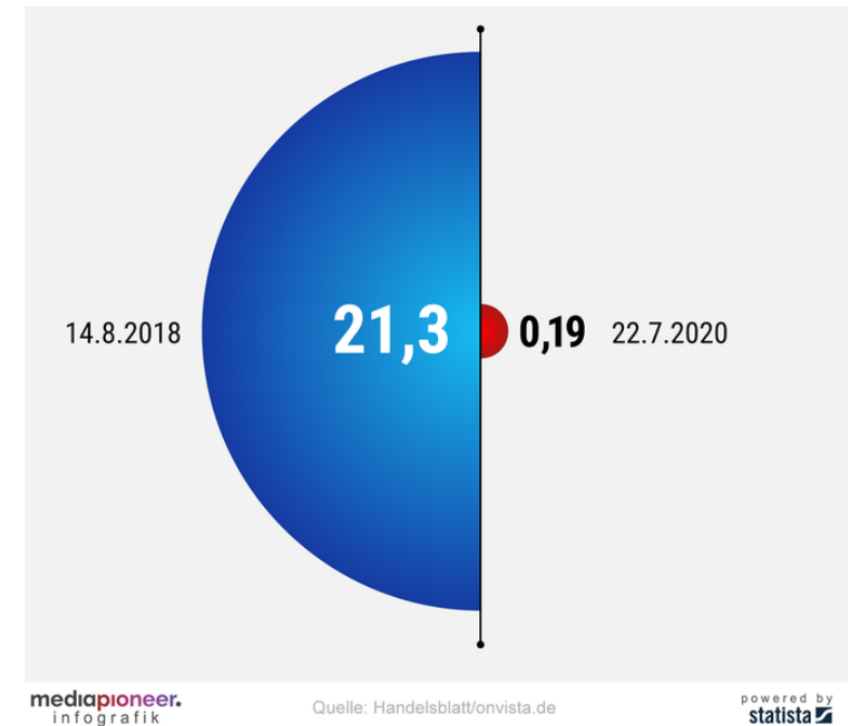


Famous Financial Statement Fraud Cases

- **Enron:** Revenue, Entities, Cash Flow, **Records**
- WorldCom: **Industry** downturn, Capitalizing
- Parmalat: „**double** bookkeeping“
- Satyam: falsifying accounts
- **Wirecard:** ???? Round-tripping?
- ?
- ?

2020:

Loss of \$ 25 Billion in 3 weeks,
Wirecard employment: 5000 people



Revenues

10 million

add 1 million „fake“
revenues

11 million

Operating

Profit

1 Million

?????

„easy documentation“ - very lucrative

Enron – high „Revenues“ vs. „Fake“ Revenues

Enron's 2000 Reported Revenue vs. Similarly Sized Companies: Too good to be true?

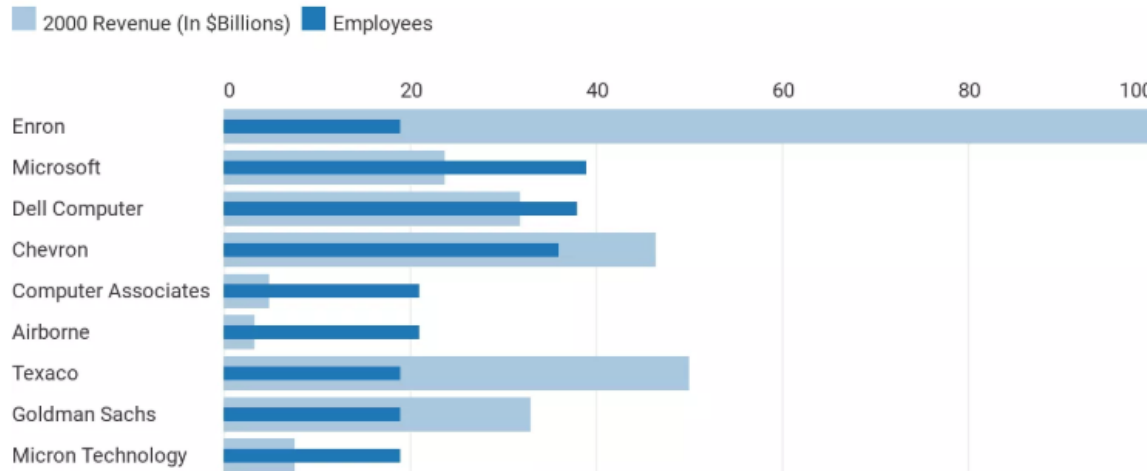


Chart: Investopedia • Source: Forbes • [Get the data](#) • Created with [Datawrapper](#)
Investopedia / Source Data: Forbes / Created using Datawrapper

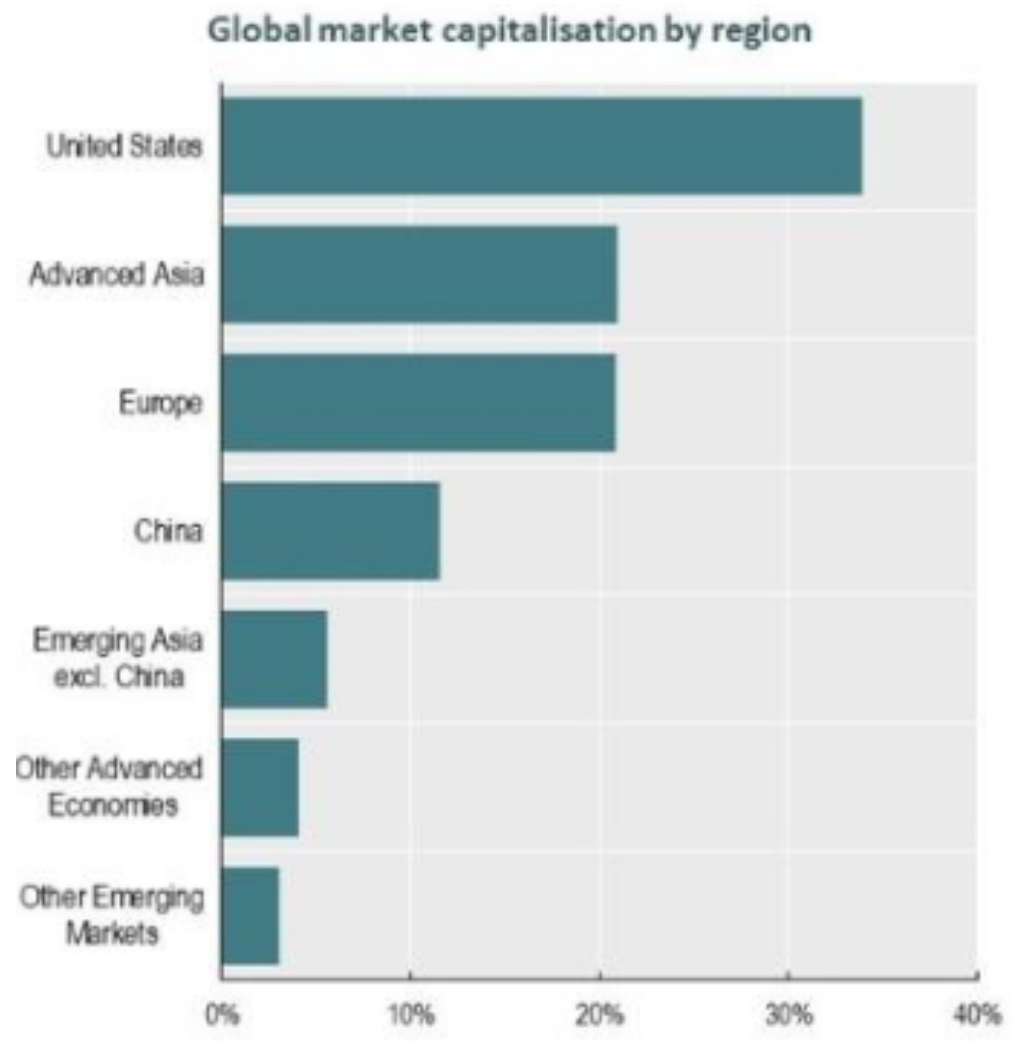
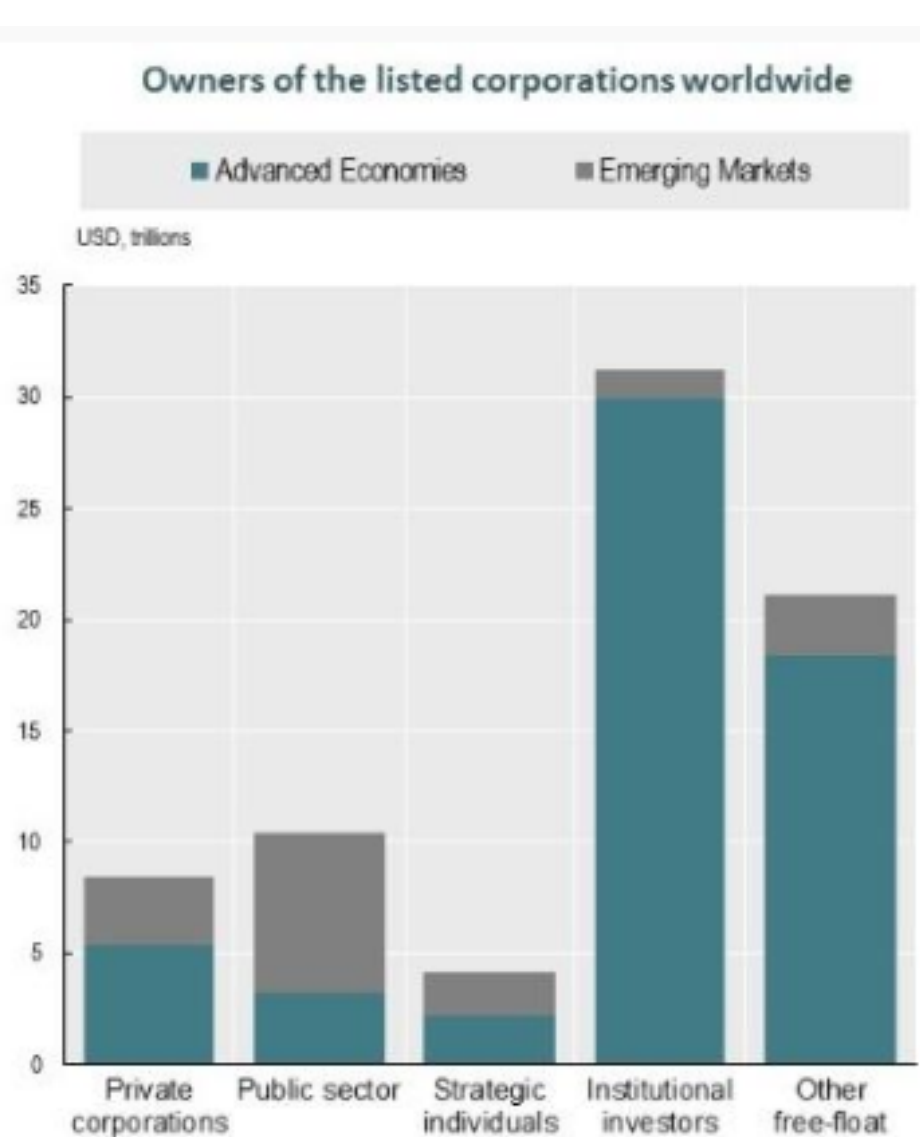
- Enron and other energy suppliers earned profits by providing services such as wholesale trading and [risk management](#) in addition to building and maintaining electric power plants, natural gas pipelines, storage, and processing facilities. [\[12\]](#) When accepting the risk of buying and selling products, merchants are allowed to report the selling price as revenues and the products' costs as cost of goods sold. In contrast, an "[agent](#)" provides a service to the customer, but does not take the same risks as merchants for buying and selling. Service providers, when classified as agents, may report trading and brokerage fees as revenue, although not for the full value of the transaction.[\[1\]](#)

Andrew S. Fastow

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Think like a fraudster

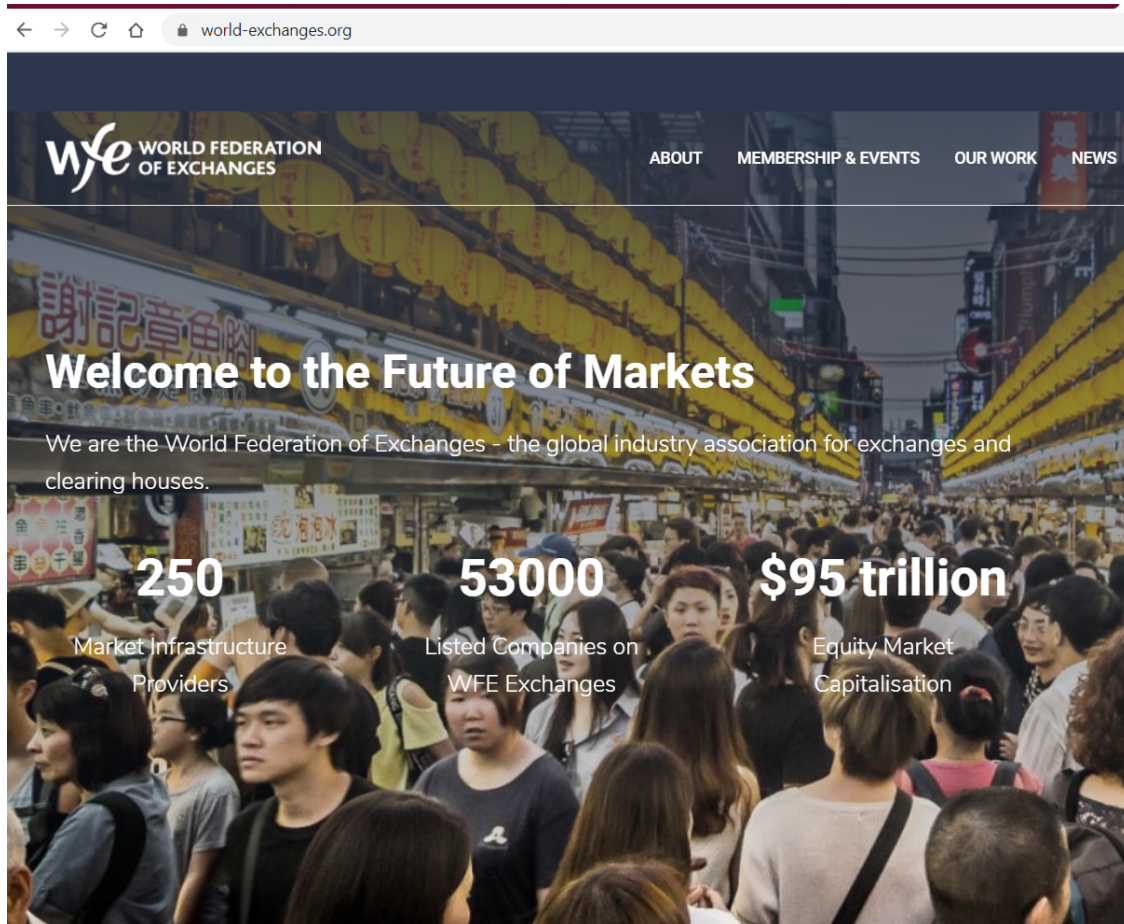


17/10/2019 – There are approximately **41 000 listed companies** in the world with a combined market value of more than **USD 80 trillion**.

This is equivalent to the global GDP. More than half of this amount is held by institutional investors and the public sector, according to a new OECD report.

Global Capital Markets

www.world-exchanges.org



Equities: 41.000 to 53.000 listings

Bonds: corporate buybacks

Other Derivatives

Currencies: \$ 5.1 tn daily turnover

Private and SME'S: **50+ Million entities**

Other entities (Not-for Profit)

Real Estate: Store of Value

They all issue (financial) **reports**



About LEI

Introducing the Legal Entity Identifier (LEI)

The Global LEI System

Global LEI System: a Network of Federated Services

Get an LEI: Find LEI Issuing Organizations

Registration Agents

GLEIF Accreditation of LEI Issuers

Accreditation Process

Introducing the Legal Entity Identifier (LEI)

The Legal Entity Identifier (LEI) is a 20-character, alpha-numeric code based on the ISO 17442 standard developed by the International Organization for Standardization (ISO). It connects to key reference information that enables clear and unique identification of legal entities participating in financial transactions. Each LEI contains information about an entity's ownership structure and thus answers the questions of 'who is who' and 'who owns whom'. Simply put, the publicly available LEI data pool can be regarded as a global directory, which greatly enhances transparency in the global marketplace.

Global Directory

[ABOUT](#)[IOSCO AGENDA](#)[SCA CONFERENCE](#)[REGISTRATION](#)[TRAVEL](#)[ACCOMMODATION](#)[CONTACT](#)

IOSCO 45TH ANNUAL MEETING 2020

16-18 NOVEMBER, DUBAI WORLD TRADE CENTRE
DUBAI, UNITED ARAB EMIRATES

TO IOSCO 2020

116
Days

23
Hours

19
Minutes

[ABOUT US](#)[AROUND THE WORLD](#)[ISSUED STANDARDS](#)[SUPPORTING IMPLEMENTATION](#)[PROJECTS](#)[NEWS AND EVENTS](#)[SERVICES](#)

Covid-19 and the IFRS Foundation:

Stay updated on how we are supporting our stakeholders during the covid-19 pandemic and how it affects the Foundation's work. [Find out more here](#)

2019 Annual Report published

IASB issues amendments to IFRS 17

Combinations of businesses under common control



IFRS Foundation publishes 2019 Annual Report

The IFRS Foundation has published its 2019 Annual Report, including the audited financial statements, 2019 reflections and a look at its priorities for 2020

Resources for

[Academics](#)[Accounting profession](#)[Investors](#)[Media](#)[National standard-setters](#)[Preparers](#)[Regulators](#)[Students](#)

Future of Non-Financial Reporting



Kurt Ramin said

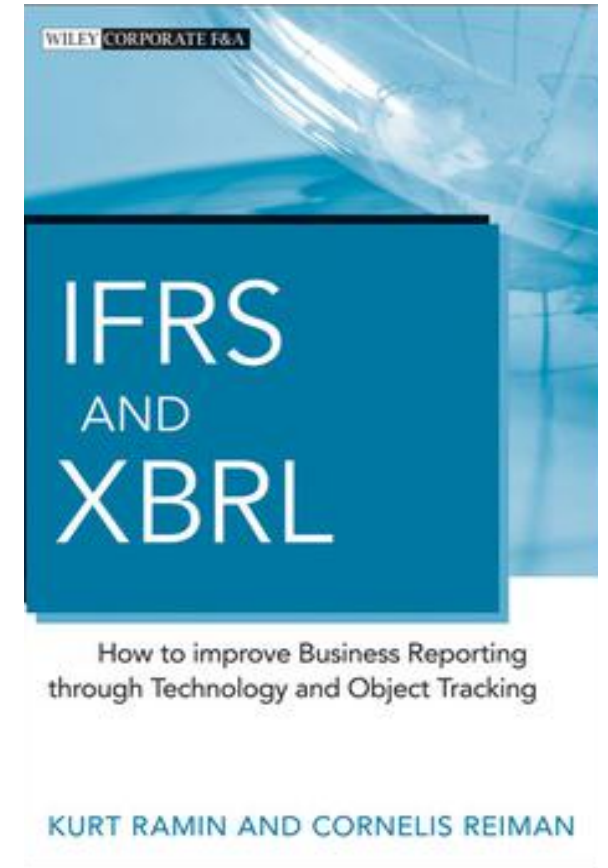
10/20/14 02:33am

For at least the last 10 years I have said that convergence will only happen through the use of technology (see Ramin/Reiman: "IFRS and XBRL – how to improve business reporting through technology and object tracking").

Mr. Cox will be remembered to push technology at the SEC and Bob Herz at the FASB for completing the codification of the US accounting literature, the base for a workable US XBRL taxonomy.

More efforts should have been made to converge taxonomies to be ready the next round of convergence – improve and integrate non-financial reporting (SASB against the rest of the world).

Codification



729 pages

Fictitious Revenues

- Involve the recording of sales of goods or services that did not occur
- If outstanding accounts never get collected, they will eventually need to be written off as bad debt expense.
- Mysterious accounts receivable on the books that are long overdue are a common sign of a fictitious revenue scheme.



Challenges to consider in auditing revenue recognition

Auditors need a complete understanding of the standard and how it affects their clients' financial statements.

By Deana Thorps, CPA; Bob Dohrer, CPA, CGMA; Kim Kushmerick, CPA, CGMA; and Toni Lee-Andrews, CPA/PFS, CGMA

July 1, 2020

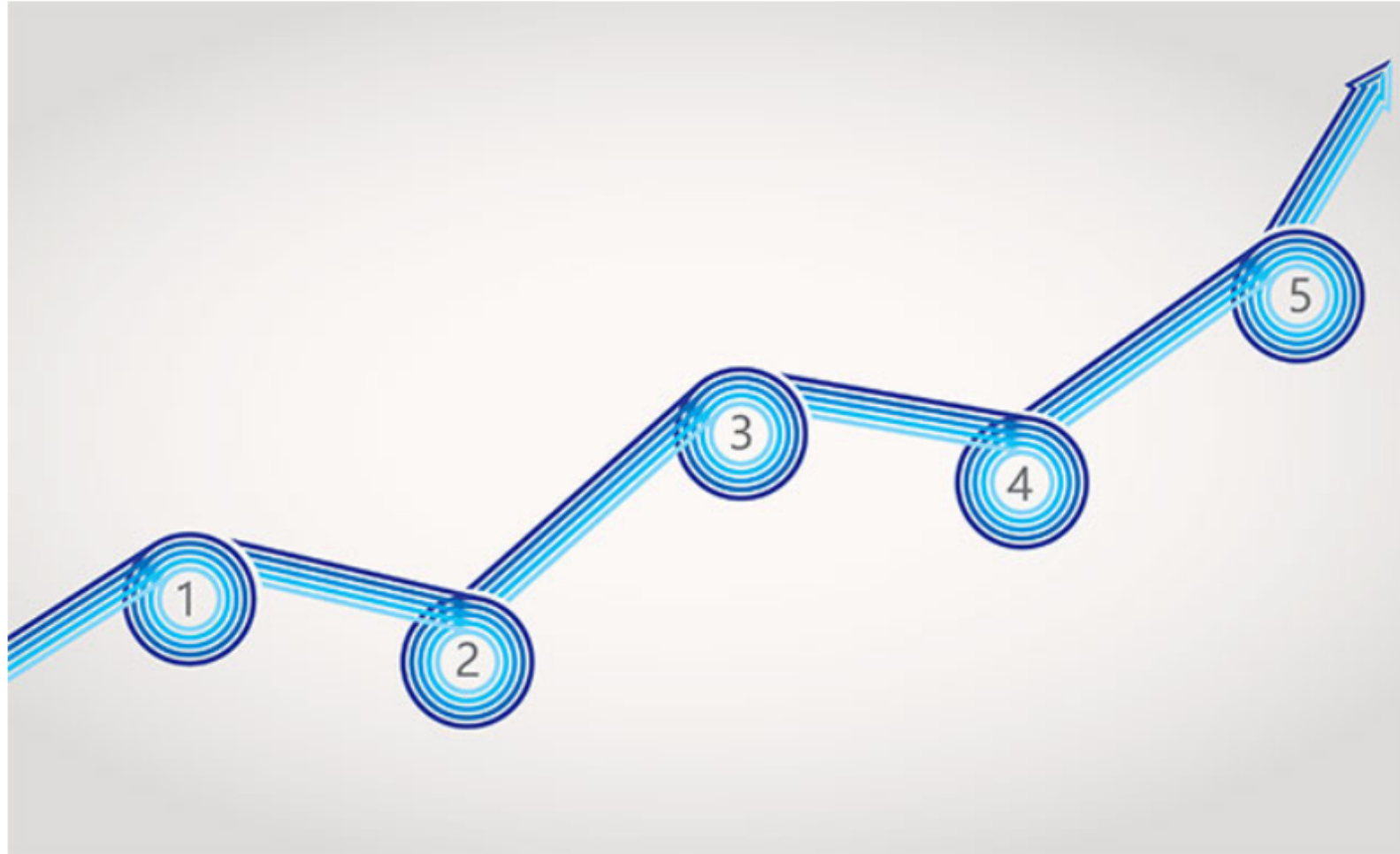


Image by IvcandyiStock

Revenue From Contracts With Customers IFRS 15

1. Identify contracts with the customer *Objects (scope, description)*
2. Identify separate performance obligations *Objects and Value (granularity and modifications)*
3. Determine the transaction price *Value*
4. Allocate transaction price to the separate performance obligations *allocate Value and Objects*
5. Recognize revenue *cut-off, avoid „cooking the books“ for period.*



AUDITING MISSTEPS

- 1: Risk assessment (internal – external, understand **objects**, consult industry - *global* - expert)
- 2: Substantive testing (work with management, CAE, range of **values**)
- 3: Documentation (evidence for **material** objects and value)

Stay independent

Five Classifications of Financial Statement Schemes

- Fictitious revenues
- Timing differences
- Improper asset valuations
- Concealed liabilities and expenses
- Improper disclosures

Red Flags

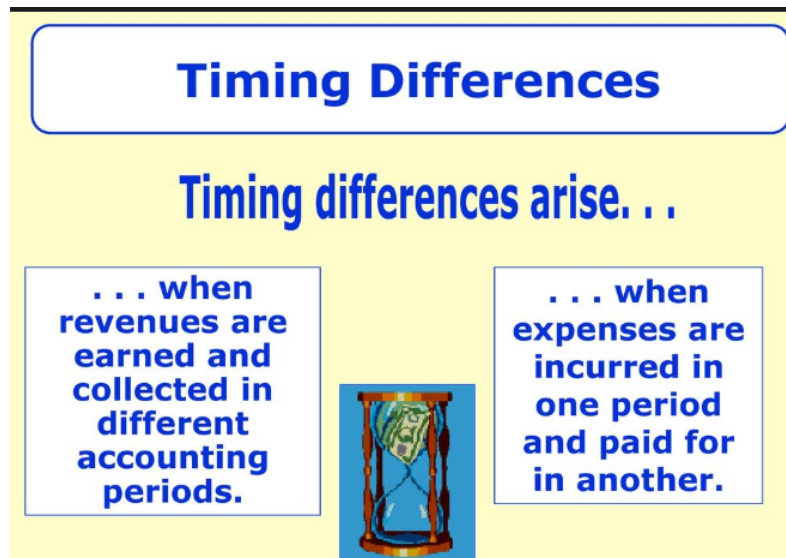
Other schemes:

accruals, book to tax, business combinations, fair value, artificial assets (leases)

Timing Differences

_Recording expenses in the wrong period : matching - pressure

- The recording of revenues or expenses in improper periods
- Shifts revenues or expenses between one period and the next, increasing or decreasing earnings as desired



Picture credit:
Pearson education

Improper Asset Valuation: Inventories and Accounts Receivable

- **Inventory** should be recorded at the lower of cost or net realizable **value**.
- Failing to write down or write off inventory results in overstated assets and the mismatching of cost of goods sold with revenues.
- Inventory can also be improperly stated through the manipulation of the **physical** inventory count, inflation of the unit cost used to price out inventory, and failure to adjust inventory for costs of goods sold.
- Fictitious inventory schemes usually involve the creation of fake documents, such as inventory count sheets and receiving reports.
- **Fictitious accounts receivable**
 - More common around end of accounting period
- Failure to account for uncollectible accounts
 - Companies generally are required to write off uncollectible receivables as bad debt expense
 - Common among companies with financial problems
 - Managers can overstate their company's accounts receivable balance by failing to record bad debt expense
 - Debits accounts receivable and credits sales

Concealed Liabilities and Expenses

- Common methods for concealing liabilities and expenses include:
 - Liability/expense omissions (contingent)
 - Improperly capitalized costs (leases – **stretch years**)
 - Failure to disclose, or improper recording of warranty costs and **product-return liabilities**, loan covenants.
- Understating or omitting liabilities/expenses makes the company appear more profitable than it actually is.

Disclosure

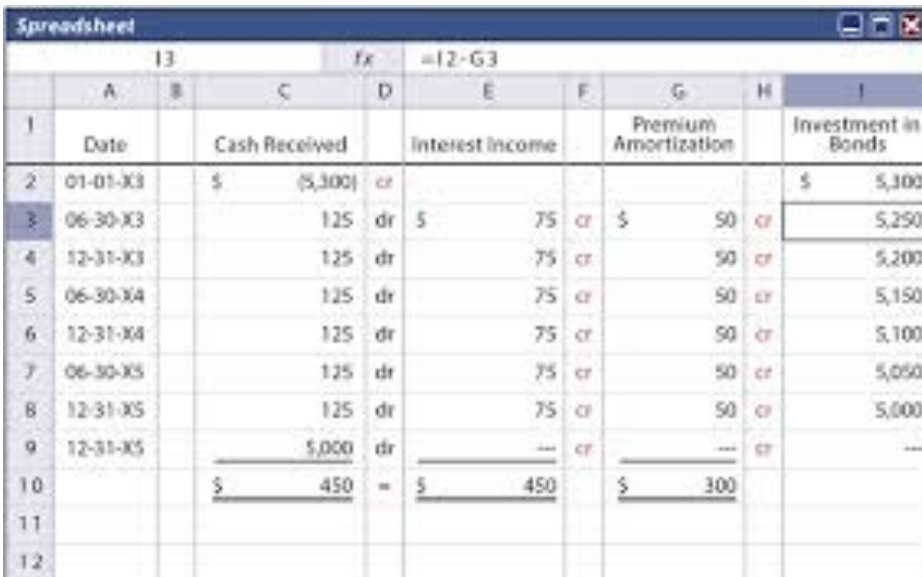
Subsequent events: Events occurring or becoming known after the close of the period could have a significant effect on the entity's financial statements and should be disclosed.

Management Fraud: Management has an obligation to disclose to the shareholders significant frauds committed by officers, executives, and others in positions of trust.

Related Parties (self dealing) – conflict of interest

Accounting Changes

- In general, three types of accounting changes must be disclosed to avoid misleading financial statement users:
 1. Accounting principles
 2. Estimates
 3. Reporting entities



The screenshot shows a spreadsheet window titled "Spreadsheet" with a formula bar displaying "=I2-G3". The spreadsheet contains a table with columns A through I. The data is as follows:

	A	B	C	D	E	F	G	H	I
1	Date		Cash Received		Interest Income		Premium Amortization		Investment in Bonds
2	01-01-X3		\$ (5,300)	cr					\$ 5,300
3	06-30-X3		125	dr	\$ 75	cr	\$ 50	cr	5,250
4	12-31-X3		125	dr	75	cr	50	cr	5,200
5	06-30-X4		125	dr	75	cr	50	cr	5,150
6	12-31-X4		125	dr	75	cr	50	cr	5,100
7	06-30-X5		125	dr	75	cr	50	cr	5,050
8	12-31-X5		125	dr	75	cr	50	cr	5,000
9	12-31-X5		5,000	dr	---	cr	---	cr	---
10			\$ 450	=	\$ 450		\$ 300		
11									
12									

Technology (Workiva) combines different sources like spreadsheets, SAP, Oracle, etc.

Financial Statement Analysis



- Vertical analysis (e.g. Profit to Net Sales)
- Horizontal analysis (e.g. year to year)
- Ratio analysis

■ ***Vertical analysis*** is a technique for analyzing the relationships among the items on an income statement, balance sheet, or statement of cash flows by expressing components as percentages of a specified base value.

■ ***Horizontal analysis*** is a technique for analyzing the percentage change in individual financial statement line items from one period to the next.

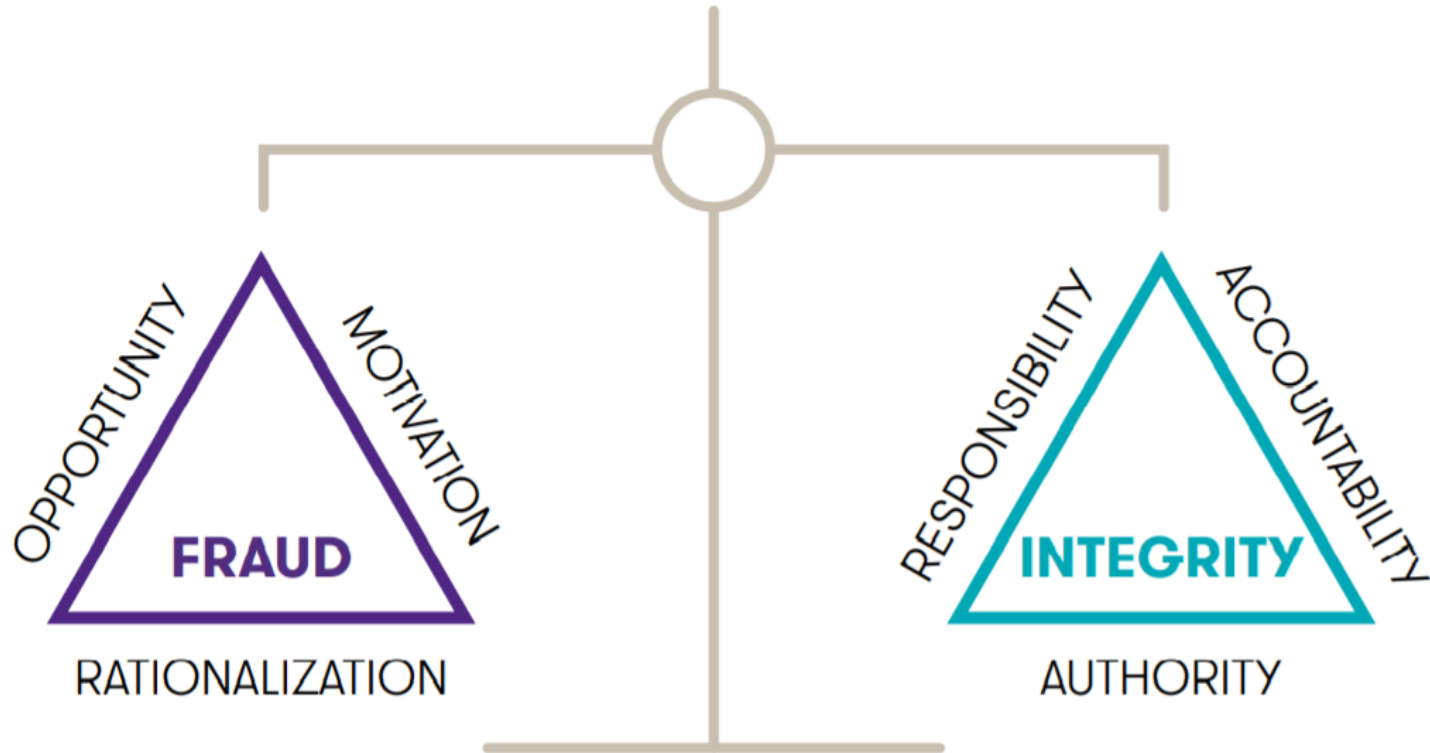
Fraud Prevention, Deterrence and Disclosure

- Governance and **Integrity**
- External Auditors (ISA 240)
- Internal Auditors (CAE), Risk Assessment (COSO, ERM and ISO 31000)
- Whistleblowing (internal and external)
- Technology (e.g. FinTech, XBRL, Workiva)
- Non-Financial Reporting
- **Change** Financial Statement Fraud to Reporting Fraud
(including tax, disclosure, other, **SBR**= Standard Business Reporting)
- **Separating Objects from Value.**

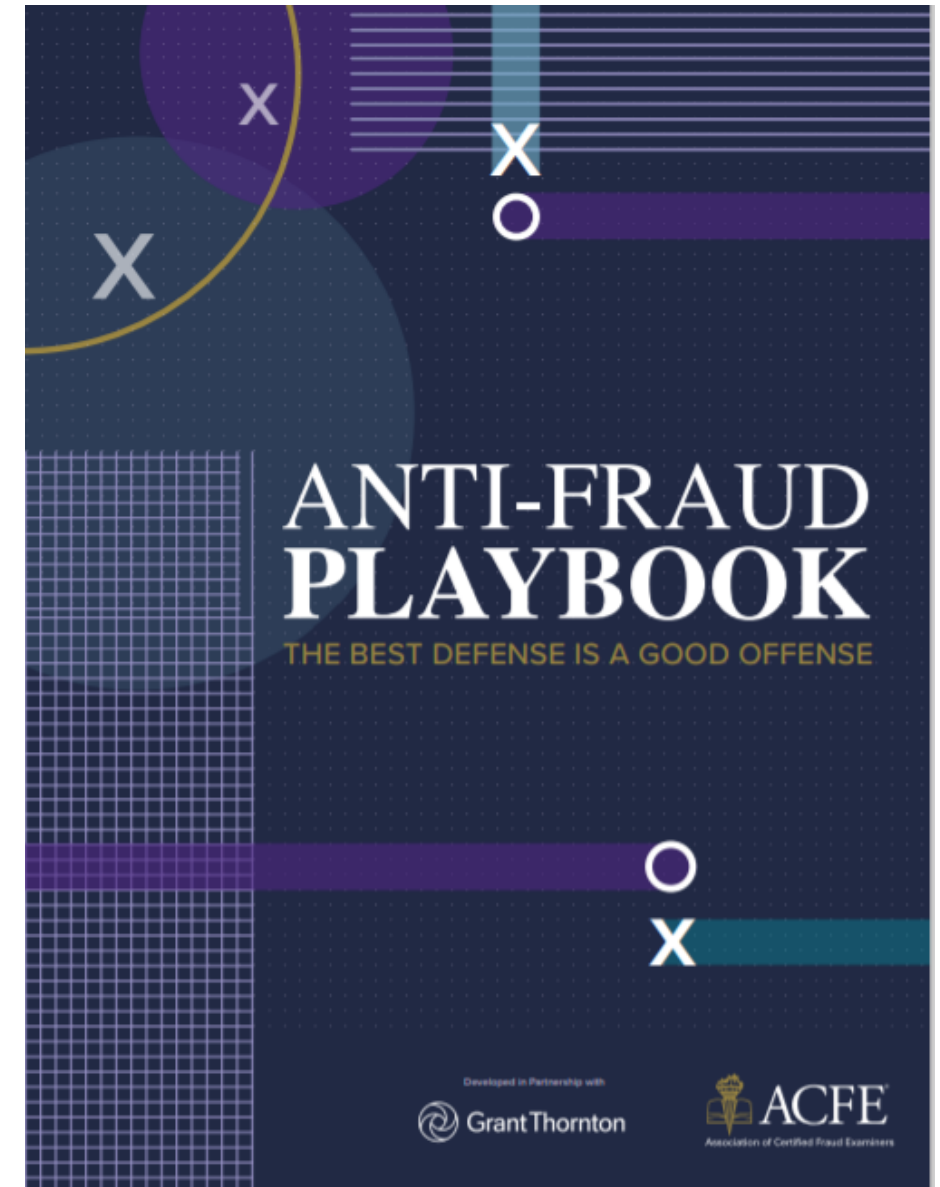
FRAUD TRIANGLE

VERSUS

INTEGRITY TRIANGLE



Counterbalance to Fraud Triangle: Governance. It builds **awareness**. It brings fraud management closer to **Risk Management**, internal audits.



Look at Business Reporting – not just Financial (book value) Journal of Intellectual Capital - Editorial Advisory Board)

Brand Finance, which produces an annual ranking of companies based on intangible value, has companies in these sectors taking the top five spots on the 2019 edition of their report.

Rank	Company	Sector	Total Intangible Value	Share of Enterprise Value
1	Microsoft	Internet & Software	\$904B	90%
2	Amazon	Internet & Software	\$839B	93%
3	Apple	Technology & IT	\$675B	77%
4	Alphabet	Internet & Software	\$521B	65%
5	Facebook	Internet & Software	\$409B	79%
6	AT&T	Telecoms	\$371B	84%
7	Tencent	Internet & Software	\$365B	88%
8	Johnson & Johnson	Pharma	\$361B	101%
9	Visa	Banking	\$348B	100%
10	Alibaba	Internet & Software	\$344B	86%

Tesla: highest valued automotive company in the world! **Apple** jumped 10% on Friday (July 31, 2020), ending the day with a record market capitalisation of \$1.817 trillion vs. Aramco \$ 1.76 trillion.

SASB Standards Are Organized by Industry

SASB Standards identify the issues most likely to be financially material for each of 77 industries



Consumer Goods

- Apparel, Accessories & Footwear
- Appliance Manufacturing
- Building Products & Furnishings
- E-Commerce
- Household & Personal Products
- Multiline and Specialty Retailers & Distributors
- Toys & Sporting Goods



Extractives & Minerals Processing

- Coal Operations
- Construction Materials
- Iron & Steel Producers
- Metals & Mining
- Oil & Gas - Exploration & Production
- Oil & Gas - Midstream
- Oil & Gas - Refining & Marketing
- Oil & Gas – Services



Financials

- Asset Management & Custody Activities
- Commercial Banks
- Consumer Finance
- Insurance
- Investment Banking & Brokerage
- Mortgage Finance
- Security & Commodity Exchanges



Food & Beverage

- **Agricultural Products**
- Alcoholic Beverages
- Food Retailers & Distributors
- Meat, Poultry & Dairy
- Non-Alcoholic Beverages
- Processed Foods
- Restaurants
- Tobacco



Health Care

- Biotechnology & Pharmaceuticals
- Drug Retailers
- Health Care Delivery
- Health Care Distributors
- Managed Care
- Medical Equipment & Supplies



Infrastructure

- Electric Utilities & Power Generators
- Engineering & Construction Services
- Gas Utilities & Distributors
- Home Builders
- Real Estate
- Real Estate Services
- Waste Management
- Water Utilities & Services



Renewable Resources & Alternative Energy

- Biofuels
- Forestry Management
- Fuel Cells & Industrial Batteries
- Pulp & Paper Products
- Solar Technology & Project Developers
- Wind Technology & Project Developers



Resource Transformation

- Aerospace & Defense
- Chemicals
- Containers & Packaging
- Electrical & Electronic Equipment
- Industrial Machinery & Goods



Services

- Advertising & Marketing
- Casinos & Gaming
- Education
- Hotels & Lodging
- Leisure Facilities
- Media & Entertainment
- Professional & Commercial Services



Technology & Communications

- Electronic Manufacturing Services & Original Design Manufacturing
- Hardware
- Internet Media & Services
- Semiconductors
- Software & IT Services
- Telecommunication Services










Transportation

- Air Freight & Logistics
- Airlines
- Auto Parts
- Automobiles
- Car Rental & Leasing
- Cruise Lines
- Marine Transportation
- Rail Transportation
- Road Transportation

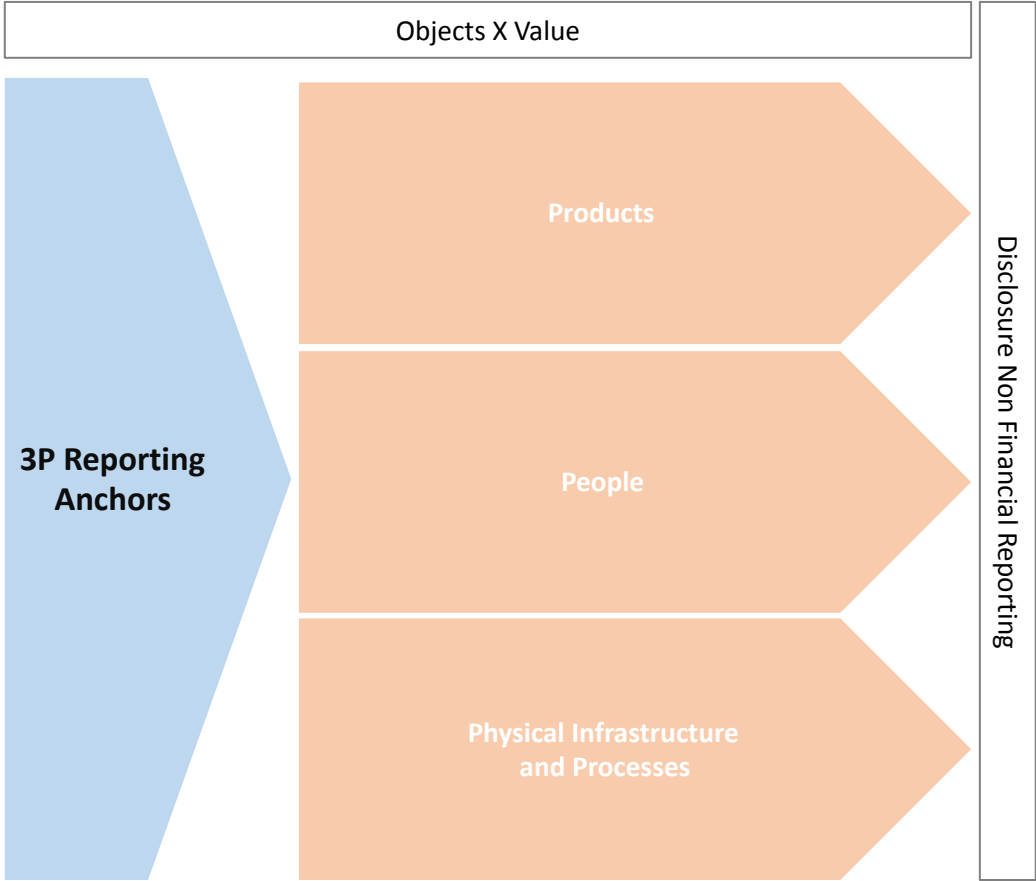
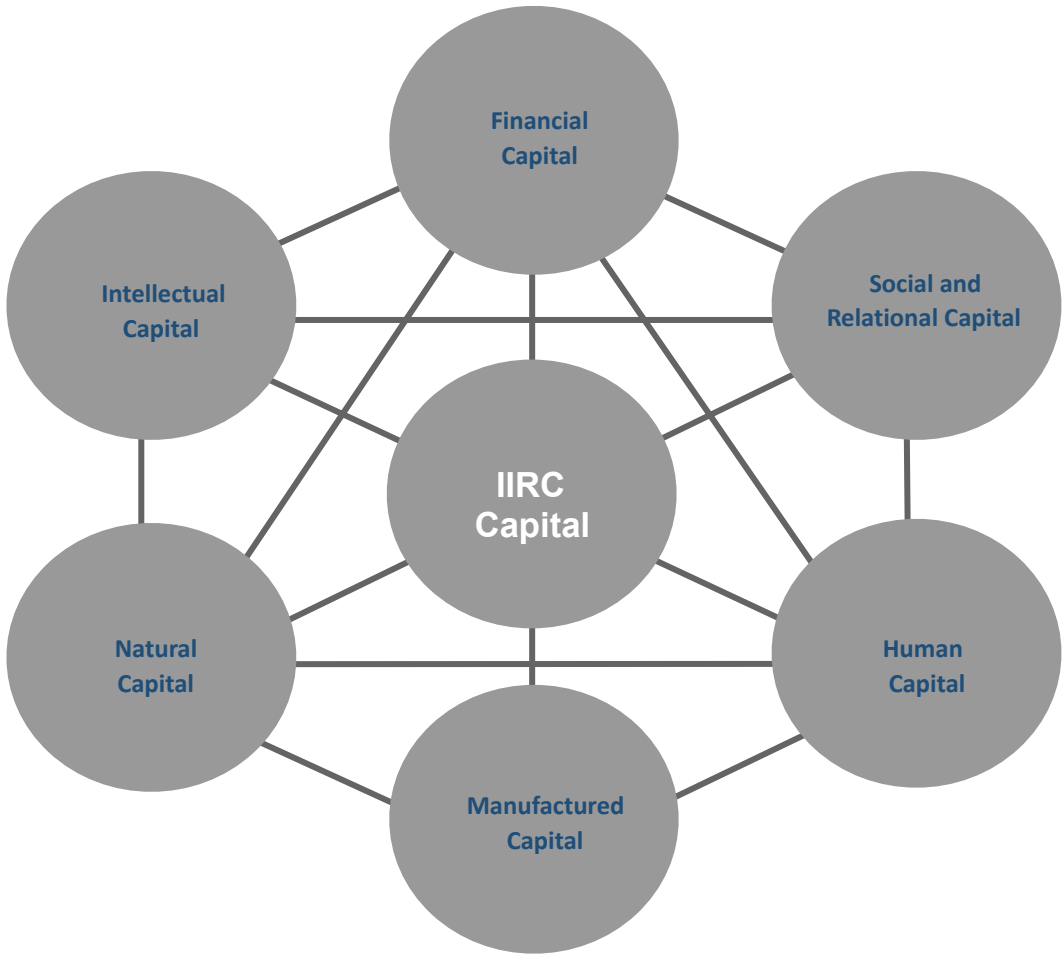
Discover your industry
for important metrics-**objects**

ESG guidelines – Fragmented focus

<https://www.xbrleurope.org/wp-content/uploads/2020/06/4-25th-XBRL-Europe-Digital-Week-SBR-and-ESG-Session-Tord-Andersson-17-Jun-2020.pdf>

Disclosure "focus"							
Environment		Environment (GRI 300)	Climate change, Water security, Forest	Natural capital	Environment (indicators)	Climate change risk & opportunity	SDG 12-15
Social		Social (GRI 400)		Human capital, Social & relationship capital	Social capital, Human capital		SDG 2-7, 11
Governance		General (GRI 103)		Intellectual capital	Leadership & governance, Business model & innovation	Governance, strategy, risk mgmt. and metrics/targets	SDG 16-17
Financial	Financial performance & position, cash flow	Economic (GRI 200)		Financial capital, Manufactured capital			SDG 1, 8-10
Established date	1973	1997	2000	2009	2011	2015	2015
Regulation status	Regulated	Voluntary framework	Voluntary questionnaire	Voluntary framework	Voluntary framework	Voluntary framework	International policy
Framework focus	General	General	Specific	General	General	Specific	
Other	Outcome, Fair Value			Integrated, Risk & future development	Financial materiality, US (10K, 20F), "10 industries"	Future, risk & opportunity	

Future of Non Financial-Reporting



Proposed Reporting Model (by entity, segment or industry)

Organize all information along the 3 Ps in a matrix format

Product input/output, People expenses and Physical infrastructure cash flow/estimates



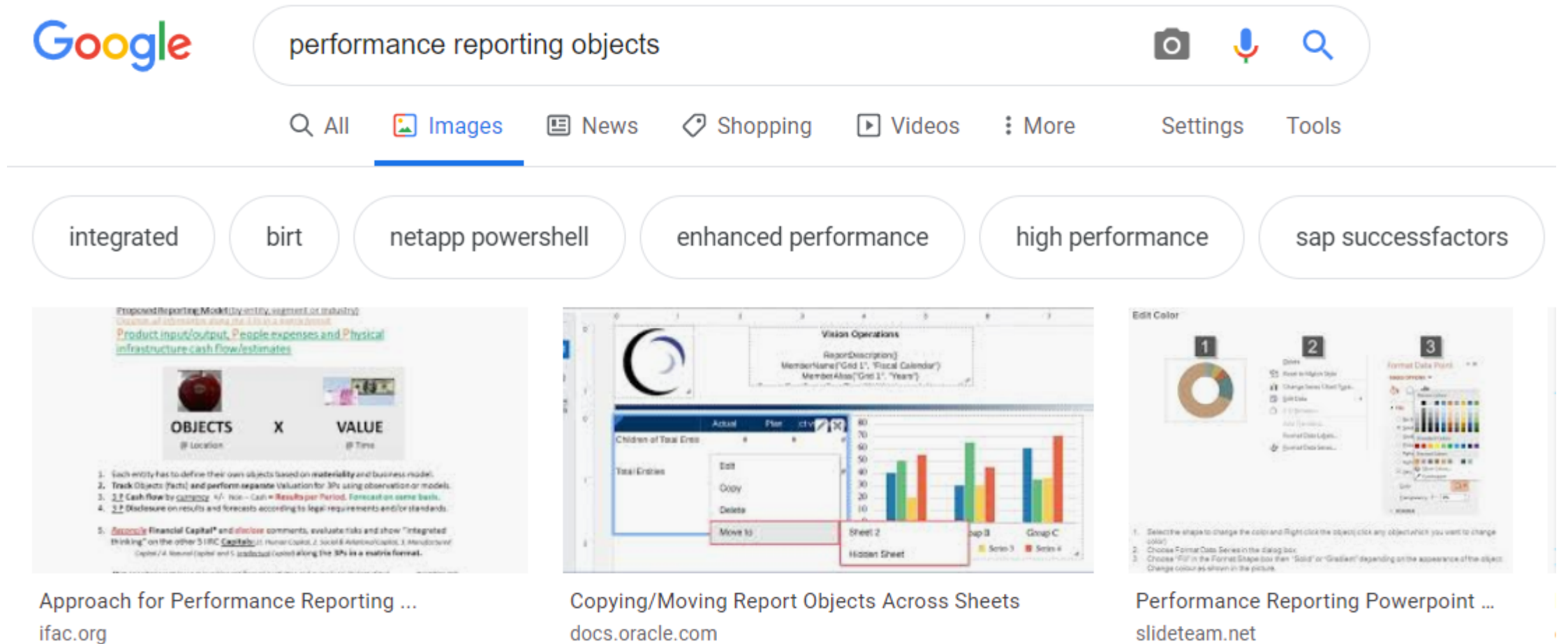
1. Each entity has to define their own objects based on **materiality** and business model.
2. **Track Objects (facts) and perform separate Valuation** for 3Ps using observation or models.
3. 3 P Cash flow by currency +/- Non – Cash = **Results per Period. Forecast on same basis.**
4. 3 P Disclosure on results and forecasts according to legal requirements and/or standards.
5. **Reconcile Financial Capital*** and **disclose** comments, evaluate risks and show “integrated thinking” on the other 5 IIRC **Capitals**: (1. Human Capital, 2. Social & Relational Capital, 3. Manufactured Capital / 4. Natural Capital and 5. Intellectual Capital) **along the 3Ps in a matrix format.**

*Net operating assets less net investing and financing activities and owner's equity (net of tax).



No 1 in google worldwide, if you just „google“

3 words: „**performance reporting objects**“ and then click on images.



The screenshot shows a Google search interface with the query "performance reporting objects" in the search bar. The "Images" tab is selected, displaying six image results. Each result includes a thumbnail, a title, and a URL.

Search Results:

- integrated**
birt
netapp powershell
enhanced performance
high performance
sap successfactors
- Approach for Performance Reporting ...**
ifac.org
The image shows a document titled "Proposed Reporting Model by entity segment or industry". It lists five steps for defining and tracking objects. A table below shows "OBJECTS" (Location) and "VALUE" (Time).
 - Each entity has to define their own objects based on materiality and business model.
 - Track Objects (Facts) and perform separate Valuation for 3Ps using observation or models.
 - 3.P Cash flow by category. $4\frac{1}{2}$ Note: Cash = Results per Period. Forecast on same basis.
 - 3.P Disclosure on results and forecasts according to legal requirements and/or standards.
 - Assess Financial Capital and disclose comments, evaluate risks and show "Integrated thinking" on the other 3 IIRC Capital: 1. Human Capital, 2. Social & Environmental Capital, 3. Manufactured Capital / 4. Natural Capital and 5. Intellectual Capital along the 3Ps in a matrix format.
- Copying/Moving Report Objects Across Sheets**
docs.oracle.com
The image shows a Google Sheets interface with a bar chart. A context menu is open over the chart, showing options: Edit, Copy, Delete, Move to, Sheet 2, and Hidden Sheet.
- Performance Reporting Powerpoint ...**
slideteam.net
The image shows a PowerPoint slide titled "Edit Color". It displays a donut chart and a color palette. The steps are:
 - Select the shape to change the color and Right click the object; click any object which you want to change color.
 - Choose Format Data Series in the dialog box.
 - Choose "Fill" in the Format Shape box then "Solid" or "Gradient" depending on the appearance of the object. Change colour as shown in the picture.

Board proposals - subtotals and categories

Revenue	347,000	Operating
Other income	3,800	
Changes in inventories of finished goods and work in progress	3,000	
Raw materials used	(146,000)	
Employee benefits	(107,000)	
Depreciation	(37,000)	
Amortisation	(12,500)	
Professional fees and other expenses	(10,030)	
Operating profit	41,270	
Share of profit or loss of integral associates and joint ventures	(600)	Integral associates and joint ventures
Operating profit and income and expenses from integral associates and joint ventures	40,670	
Share of profit or loss of non-integral associates and joint ventures	3,380	Investing
Dividend income	3,550	
Profit before financing and income tax	47,600	
Expenses from financing activities	(3,800)	Financing
Unwinding of discount on pension liabilities and provisions	(3,000)	
Profit before tax	40,800	
Income tax	(7,200)	
Profit for the year	33,600	

3Ps: clean up: anchor for disclosure and relate to direct version of Cash Flow Statement.

Separation of Objects from Value – Look for what was stolen and who did it.

Dr. Mukhisa Kituyi, Secretary-General, UNCTAD.

Many challenges still lie ahead in the area of accounting and reporting. Building an efficient accounting and reporting system requires the development of appropriate policies and regulations, a strong institutional base and adequate resources.

Get involved in the discussion.



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https://www.youtube.com/watch?v=TEwOZ_N4wfQ



Think like a fraudster