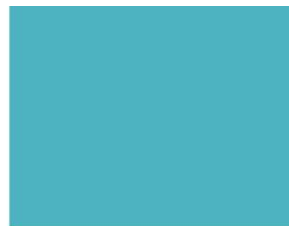


IAPA EMEA and Asia Pacific Regional Conferences Dubai 2017

Recent trends in financial fraud and detection techniques

Mr Uday Gandhi, US Gandhi & Co, India



What is Financial Fraud?

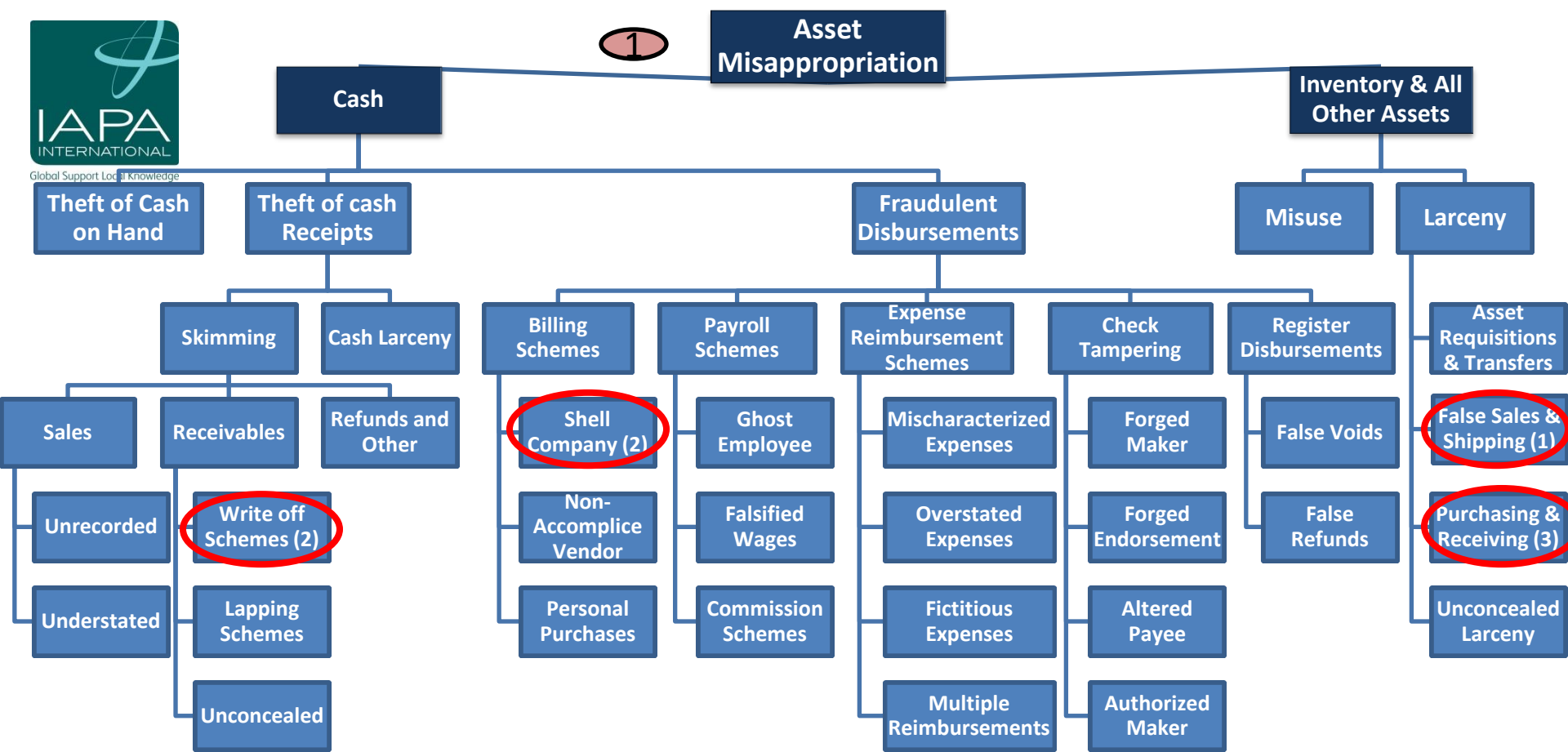
- Financial fraud can be broadly defined as –
 - an intentional act of deception involving financial transactions for purpose of personal gain.
- Fraud is a human act.
- Ingredients of financial frauds are deception, conspiracy and connivance.
- In case of financial fraud, few people conspired with each other to gain pecuniary advantage at the loss of others.

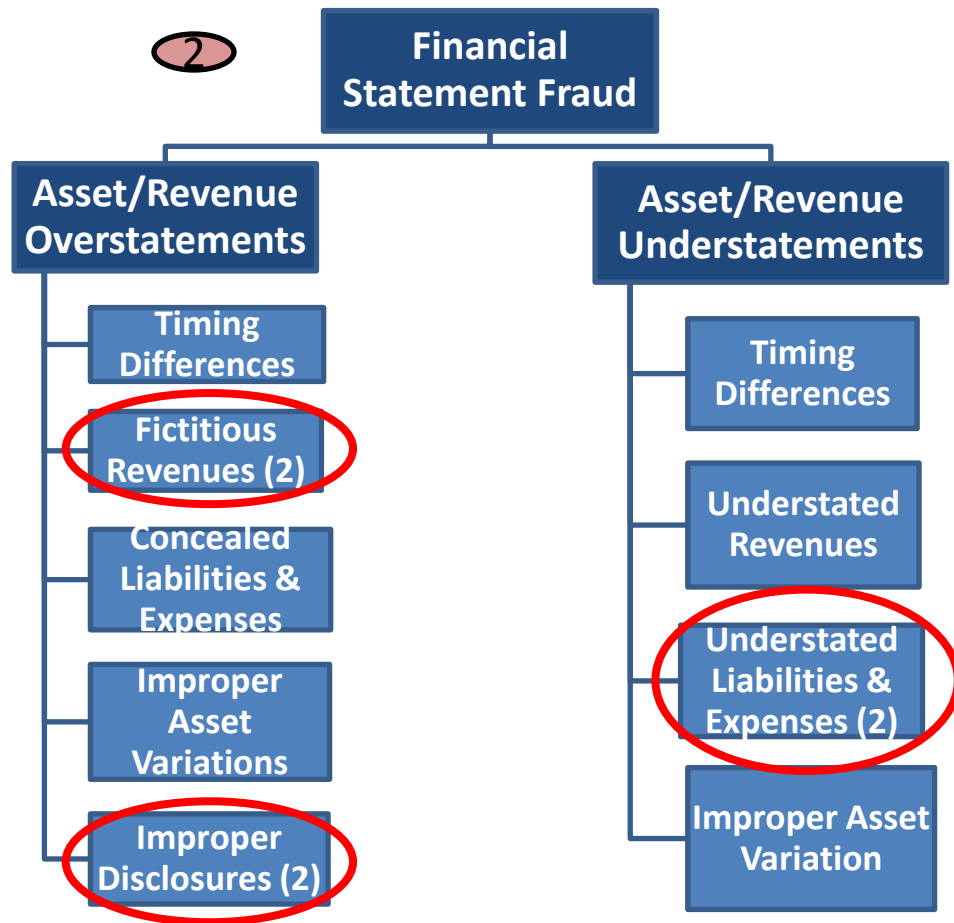


Three Broad Categories of Financial Frauds

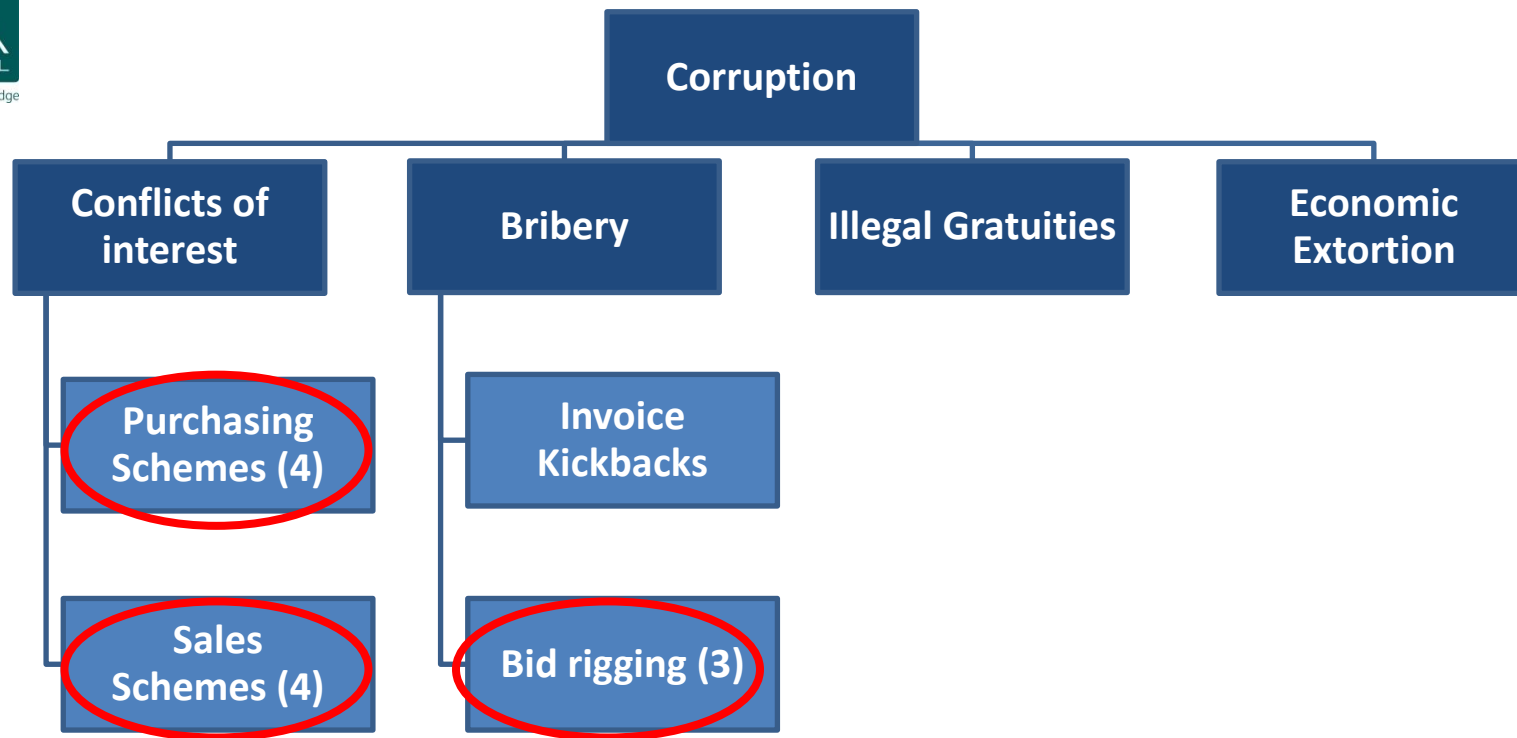
1. Asset Misappropriation
2. Financial Statement Fraud
3. Corruption being part of fraud







3



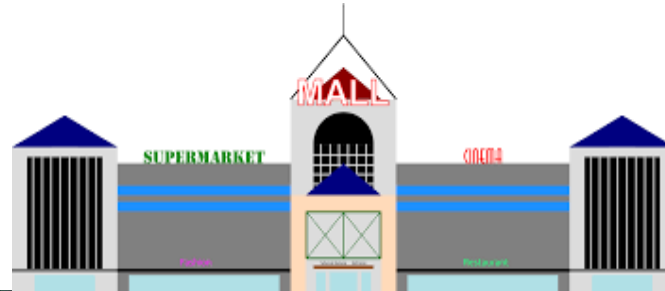


CASE STUDY

1

Asset Misappropriation – Theft of Inventory & Cash

Facts of the case



Facts of the case

- A robbery took place in a mall in January 2006
- Thieves broke the door
- They stole cash worth more than US\$ 70,000
- Police complaint lodged
- Police made inquiries with staff, neighborhood



Findings of the Police

- They concluded that this was the work of a **local gang** of thieves operating in the area and this mall was the latest victim
- They suspected that **some employee may have helped** but could not get specific clues against anyone
- They recommended better locks and greater security.

Case virtually closed.



Management appointed Forensic Auditor/ auditors who were specialized investigators more for studying controls and recommending preventive measures.



Detection Techniques



Detection Techniques used

- **Tiger Team test –**

Tests used to assess the robustness of a system by actually carrying out an attack and penetration tests as in ethical hacking.



- **Space – Time Dimension Approach –**

Both space and time offer testing yardsticks for audit purposes. Time can be used in several ways, time of transaction, time taken for the transaction, time difference between two events etc. Hence, this approach is used to detect the wrong doings.



Findings



Forensic Auditor spots red flags

The **time element** indicated that the thieves had only 20 minutes to complete the robbery while the patrolling guards were circling the mall

- How could they throw all contents of all drawers?
- Where did they have time to steal a few cell phone handsets which were on a different floor?
- The alarm had been switch off. Therefore it was certain that someone had helped them
- The door that was broken was done with crude tools. Hence, it is not the work of a professional gang
- Out of two safes only one was broken and robbed. The second was left untouched?



Forensic Auditor spots red flags



- Forensic auditor compared and analyzed daily cash turnover of last few months and found that cash sales of last two days were significantly higher than average daily cash turnover.
- This enabled them to draw possibilities of fraud timing.
- The LOGIN ID was traced – the store manager. On being questioned he confessed
- There was no robbery - it was a stage managed robbery to cover up stock shortages
- The shortages were built up over a period of time. The store manager panicked when he was told that a stock taking was to take place.

Forensic Auditor spots red flags

- He converted the stock shortages into ‘artificial’ sales by entering sales at midnight along with his accomplice the head cashier during the previous two nights. **This resulted into stock shortages being converted into cash shortages.**
- This shortage was then palmed off as robbery by breaking the door and throwing papers and documents in the cash room to make it look like a robbery.
- Conspiracy and connivance between store manager, head cashier and security guards was established and criminal complaint has been filed against them.



CASE
STUDY

2

Financial Statement Fraud

Facts of the case



Facts of the case



- ABC Limited is a listed public company.
- It had average turnover of around US\$ 1500 MN p.a. over a period of last 10 years.
- The company had taken a loan of US\$ 110 MN from a bank based on such huge turnover and hypothecated its inventory, debtors, etc.
- The company reported huge losses for the first time in FY 2015-16.
- The non-consortium has appointed a forensic firm to conduct forensic audit and to find the possible fraud & misappropriation that the company might have committed.
- Books of accounts, invoices, vouchers, etc. were not made available to forensic auditor to keep the assignment confidential. Also, the bank could not share with all the bank statements as the company was dealing with various bank.



Detection Techniques





• Analysis of Financial Statements:

- Analysis of financial statements of the defaulting company available on public domain.
- Comparative and trend analysis of financial statements with respect to preceding years.
- Use of various financial and leverage ratios such as Operating profit ratio, Net margin ratio, Sales growth ratio, EBITDA growth ratio, Debt-equity ratios.
- Examining related party transactions, notes to accounts, auditors report & qualifications made in the auditor's report.
- Scrutinizing list of top debtors companies and advances given.
- Obtaining and analysing financial statements of these top debtors companies available on public domain.
- Analysing financial capacity of these top debtors companies.
- Finding relationship between directors of these top debtors companies with the directors of defaulting company.

Detection Techniques used

- Establishing nexus between management of these top debtors companies with defaulting company.
- Tabulating list of debtors and advances given with their registered offices, name of the auditors, directors, etc. ; analyzing the same and preparing the list as 'Exhibit'.
- **Background Check:**
 - Background check of the promoters/directors/key employees of the company through digital and social media.
 - Examining court cases filed against the company/promoters and other companies where promoters have interests.
 - Background check of directors of the top debtors companies through digital & social media

Findings





Analysis of Audited Balance sheet of ABC for last 7 years

ABC Limited

Balance Sheet (Standalone) (US\$ in millions)

Particulars	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Sources of Funds							
Share Capital	8.43	6.85	6.87	6.88	6.88	6.88	6.88
Reserves & Surplus	184.05	208.72	213.82	229.74	226.96	213.88	113.51
Net worth	192.48	215.58	220.68	236.62	233.85	220.76	120.39
Secured Loans	68.53	65.64	79.97	103.74	104.79	69.96	42.19
Unsecured Loans	166.10	252.04	378.74	440.13	152.02	254.83	409.19
Total Loans	234.63	317.67	458.71	543.87	256.81	324.80	451.38
Non Current Liabilities & Provisions	16.87	21.73	28.78	27.46	28.49	46.20	29.19
Total	443.98	554.98	708.17	807.95	519.14	591.75	600.96
Application of Funds							
Net Fixed Assets	202.49	228.52	258.20	269.31	263.95	248.07	235.11
Investment	18.13	18.68	21.03	26.11	32.33	28.18	22.87
Other Non Current Assets	-	11.34	8.47	11.89	9.70	13.52	17.97
Current Assets	529.37	696.52	980.57	1,135.39	925.04	1,097.12	1,071.57
Current Liabilities (Other than Bank Loan)	291.57	371.71	529.25	606.89	675.43	756.12	707.63
Current liabilities - Bank Loan	14.46	28.41	31.01	27.88	36.47	39.05	39.00
Total Current Liabilities	306.03	400.12	560.26	634.77	711.90	795.17	746.63
Net Current Assets	223.34	296.41	420.31	500.61	213.14	301.95	324.94
Misc. Expenditure Without Written off	0.02	0.03	0.17	0.03	0.02	0.03	0.07
Total	443.98	554.98	708.17	807.95	519.14	591.75	600.96

Analysis of Statement of Profit & Loss of ABC for last 7 years

ABC Limited

Statement of Profit and Loss (Standalone) (US\$ in millions)

Particulars	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Sales	1,341.11	1,650.35	2,583.81	2,591.76	2,405.96	2,775.65	2,773.46
Total Expenditure	1,315.41	1,620.99	2,533.33	2,572.48	2,386.73	2,778.56	2,799.78
EBIDTA	25.70	29.36	50.48	19.28	19.23	-2.91	-26.31
Depreciation	12.03	11.99	14.07	15.43	16.45	14.80	14.99
EBIT	13.67	17.37	36.41	3.85	2.78	-17.71	-41.30
Interest Cost	6.74	11.79	52.13	31.61	53.05	46.23	61.87
Operating Profit	6.93	5.58	-15.72	-27.76	-50.27	-63.94	-103.18
Operating Cash Flow	18.65	-88.23	90.62	-145.08	345.12	-50.79	NA
Other Income	19.97	27.22	38.27	58.11	54.15	65.40	7.08
Extraordinary Item	0.35	-	-	-	1.11	6.49	2.39
PBT	27.25	32.80	22.55	30.35	4.98	7.95	-93.70
Tax	10.00	11.48	10.60	6.73	3.63	1.97	-7.99
PAT	17.25	21.32	11.95	23.62	1.35	5.99	-85.72
PAT Margin (%)	0.01	0.01	0	0.01	0	0	-0.03
Sales Growth (%)	0.0%	23.1%	56.6%	0.3%	-7.2%	15.4%	-0.1%
EBITDA Growth (%)	0.0%	14.3%	71.9%	-61.8%	-0.3%	-115.1%	805.5%
PAT Growth (%)	0.0%	23.6%	-43.9%	97.6%	-94.3%	343.1%	-1532.0%

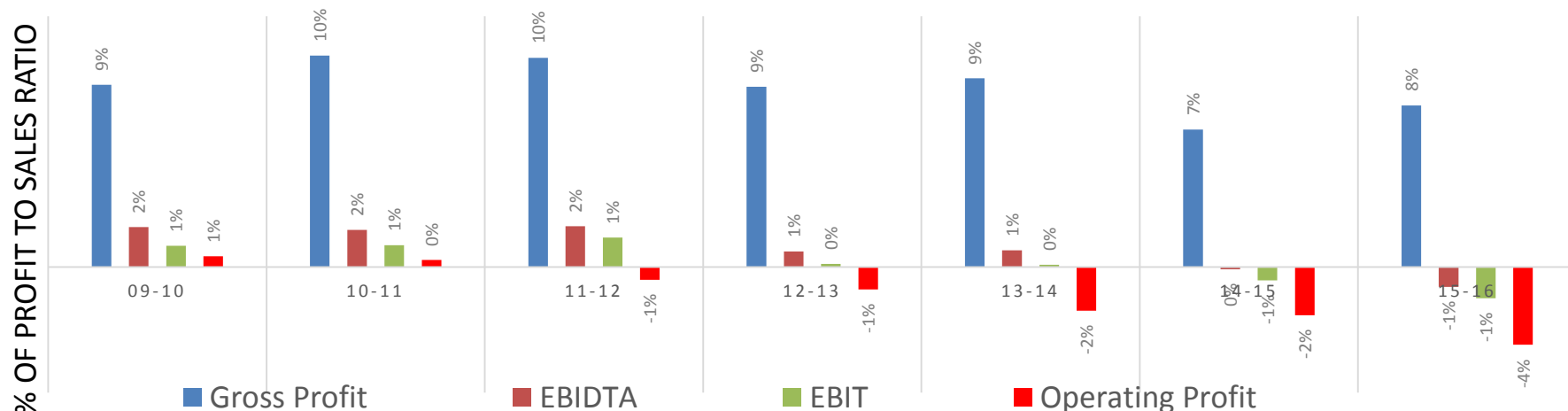
Operating Profit to Turnover

Global Support Local Knowledge

Ratio analysis of ABC Ltd (US\$ in million)

Particulars	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Sales	1,341.11	1,650.35	2,583.81	2,591.76	2,405.96	2,775.65	2,773.46
Gross Profit	117.01	167.09	258.74	223.45	217.32	182.64	214.51
EBIDTA	25.70	29.37	50.47	19.27	19.23	-2.91	-26.31
EBIT	13.67	17.37	36.40	3.85	2.78	-17.71	-41.30
Operating Profit	6.93	5.58	-15.73	-27.76	-50.27	-63.94	-103.18

PROFITS TO SALES RATIO



Comparison of EBIT with Interest cost

The company EBIT and interest cost for the last 7 F.Y. is as under;

US\$ in millions

F.Y.	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
EBIT	13.67	17.37	36.41	3.85	2.78	(17.71)	(41.30)
Interest Cost	6.74	11.79	52.13	31.61	53.05	46.23	61.87

The comparative chart of EBIT & Interest cost reveals that from F.Y. 2011-12 interest cost was higher than EBIT.

The only way to service interest was out of other income which is reflected as under;

US\$ in millions

F.Y.	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Other Income	19.96	27.25	38.27	58.11	54.15	65.40	7.10

As can be seen from above it is other income only totaling US\$ 270.2 millions in last 7 years that has serviced the interest. This necessitated to further analyze the nature of other income earned by the company in the above period.

From this
Exhibit, what
odds or evens
can be found?

Sr.No	Name of Companies	Address	Name of Auditor	Directors of the company	As on 29/02/2016 Audited by CA	As on 31/03/2016 as per list provided	Advances Given as on 31/03/2016	Remark (Findings from Social media)
					US\$ in millions			
1	JDK Impex Pvt Ltd	7/B, Rose Villa, Mumbai	M/s AK Wala & Co.	1)Mr. NA Paliwal (10/03/2010) 2)Mr. AB Agarwal (01/09/2014) 3)Mr. SS Gangrade 4)Mr.VK Gupta	10.89	19.75	2.30	Mr. AB Agrawal Employee of ABC Ltd
2	STU Multitrade Pvt Ltd	Office No. 46, Flower Apt. Mumbai	M/s. GH Hupta & Co. ✓	1)Mr. RP Hardiya (01/10/2012) 2)Mr. AB Agrawal (10/10/2014)	2.43	23.58	-	
3	PQR Marketing Pvt Ltd	Office No. 36, Flower Apt., Mumbai	M/s AK Wala & Co.	1)Mr. PP Nagar (01/12/2010) 2)Mr. SL Jain (01/10/2012)	13.84	24.98	1.40	
4	FGH Impex Pvt Ltd	10GH, Jasmine Apt., Mumbai	M/s. GH Hupta & Co. ✓	1)Mr. PP Nagar (01/09/2014) 2)Mr. DK Gupta (31/03/2000)	21.04	24.12	-	Mr. PP Nagar Employee of ABC Ltd
5	SQR Trading Pvt Ltd	7/B, Rose Villa, Mumbai	M/s. CJ Jain & Co.	1)Mr. SH Kurkute (05/01/2011) 2)Mr. PP Nagar (15/07/2015) 3)Mr. VY Sharma (20/01/2003)	-	-	6.00	
6	RST Impex Pvt Ltd	10GH, Jasmine Apt., Mumbai	M/s. GH Hupta & Co. ✓	1)Mr. RH Gupta (25/10/2002) 2)Mr. RS Patwal (18/09/2002)	0.98	16.59	-	Mr. RH Gupta Employee of ABC Ltd
7	RRR Trading Pvt Ltd	Office No. 36, Flower Apt., Mumbai	M/s AK Wala & Co.	1)Mr. NA Paliwal (10/03/2010) 2)Mr. RH Gupta (24/03/2003)	-	-	1.55	
8	GHI Multitrade Pvt Ltd	Office No. 46, Flower Apt. Mumbai	M/s. GH Hupta & Co. ✓	1)Mr. SD Parashar (01/10/2009) 2)Mr. PH Gupta (17/06/2006)	3.70	24.75	-	Mr. SD Parashar Employee of ABC Ltd
9	ACD Trading Pvt Ltd	Office No. 36, Flower Apt., Mumbai	M/s. SBP Satidar & Co.	1)Mr. SD Parashar (30/03/2009) 2)Mr. RH Gupta (01/01/2004)	-	-	6.57	
10	MNO Multitrade Pvt Ltd	Office No. 36, Flower Apt., Mumbai	M/s. GH Hupta & Co. ✓	1)Mr. SD Parashar (01/10/2009) 2)Mr. PH Gupta (17/06/2002)	-	26.40	-	
11	XYZ Marktrade Pvt Ltd	7/B, Rose Villa, Mumbai	M/s. SBP Satidar & Co.	1)Mr. SL Jain (01/09/2014) 2)Mr. RR Khande (15/03/2009) 3)Mr. SS Gangrade	15.38	-	-	Mr. SS Gangrade Employee of ABC Ltd
TOTAL					68.26	160.16	17.82	
					Total Diff: 91.90		Total: 177.9	

Findings

- After preparing 'Exhibit' and analyzing the same, it was surprised to find that these top debtors of the companies had common Directors, common Auditors, common Registered addresses, etc.
- Further by the use of digital and social media like Facebook, LinkedIn, etc., we found that these directors / employees were past / present employees of the company. Indirectly, these companies were controlled by the directors of ABC Ltd.  **Linked**  
- Further, we linked the turnover and recovery position of these debtors companies. By this we found that these debtors companies are overdue for payments.
- On downloading these debtors companies financial statements from the public domain, it was observed that their paid up share capital is only US\$ 0.1 million and a huge losses were booked in their balance sheets.

- This logically implies that the turnover to these debtors companies are only paper turnover to create huge volume of turnover in order to renew and enhance the bank loan.
- On the study of financial statements of Debtors of the company, it was found that there was huge diversion of fund to related parties and stock has been written off as non-moving resulted into huge losses. Thus, company camouflaged fraud as non-recovery of debtors; business failure.
- Conspiracy and connivance between management and its associates have been established to dupe the bank's fund and accordingly criminal complaints were filed against defaulting company.
- However, it was a fit case of willful defaulter and money laundering of bank funds.





CASE STUDY

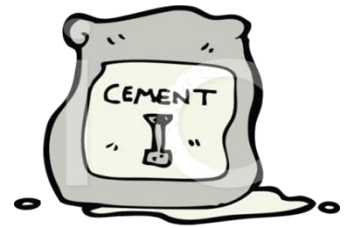
3

Corruption – Bid Rigging

Facts of the case



Facts of the case



- ABC Inc. was a 45 year old family managed construction firm.
- Over the years the day to day responsibilities and powers were delegated to head of departments employed by the company.
- One of the suppliers, who has been associated with the family for over 30 years, complained to the promoter for continuous delay in payments.
- The promoter contacted the purchase head and finance head of his company and the matter was immediately sorted out.
- After a few months, again an another supplier close to the promoters complained about the same issue.
- This time the promoter did not take it lightly and decided to appoint a forensic auditor to investigate the matter.



Detection Techniques



Detection Techniques used

- Analysis of quotations, contracts and agreements.
- **Digital Forensic – By use of Forensic tools / software :**
 - CaseWare IDEA for analyzing aging of each creditor.
 - EnCase and Neutrinos for detailed computer, laptops, hard drive, flash drives and mobile devices investigation by searching and scanning data by putting key words like commission, favour, gratitude, kickback, speed money, facility money, etc. for finding collusion, corruptive chats, wicked mails
 - Data Recovery & Analysis Computer for investigation and recovery of digital artifacts;
- **Interview & Interrogation** : This involves questioning directly and indirectly by forensic experts to examine the suspected transactions so as to make the suspect/fraudster confess.



Findings



Forensic Auditor spots red flags



- Yearly cement purchase contracts were awarded to the lowest bidder and 4 quotations were called for each year.
- It was observed that every year the contract was awarded to a same person with his different names of companies.
- Strangely it was observed that always 3 bidders were common whose bids were always higher.
- Searches and scanning through the laptops and email accounts of purchase manager revealed soft copies of the quotation of the bids of all three companies.
- On inquiring about the company and making telephone calls at the displayed numbers it was learnt that the company existed but they were steel and hardware suppliers and not of cement.

Forensic Auditor spots red flags



- On this basis, interview and interrogations of the purchase manager were made by ex-police service men.
- The manager confessed of falsifying quotations.
- He also revealed that he received a kick-back from the successful bidder which he shared with the finance manager on release of payment.
- So that no one suspects this arrangement he ensured that the successful bidder is a new company each year.
- On producing the confession of the purchase manager and document trail, the finance manager immediately confessed being part of the fraud.
- On making further enquiry, it was revealed that purchase manager in connivance with finance manager used to delay payments of smaller creditors to make funds available for the company to whom the contract was awarded.



CASE
STUDY

4

Corruption – Purchasing & Sales Schemes

Facts of the case



Facts of the case

- Government Policy to boost export of Gold & Diamond Jewellery over US\$ 16.7 million p.a.
- Few privately held companies namely A, B, C, D approached PSU.
- MOU was entered between PSU & A, B, C, D.
- It contained following clauses :
 - All responsibilities of manufacturing, designing, recovery will be of A, B, C, D, only export will be made through PSU.
 - Initially, payment terms were immediate against delivery of goods exported.
 - Later on, after winning confidence, the terms of payments were changed from spot payments to 120 days credit i.e. on shipment, 80% of invoice value will be paid to A, B, C, D by PSU and the balance 20% amount after receiving money by PSU from customers.
 - Agents were appointed in foreign countries i.e. in Dubai by A, B, C, D.



Facts of the case

- First US\$ 3.33 million transaction of export to Dubai customers was successful without giving any credit
- Later on in next transaction involving over US\$ 16.7 million, after shipment 80% of export invoice was released by PSU to A, B, C, D.
- On due dates, export bills could not be realized and on enquiry, foreign customers made default and it was noticed that they didn't receive any goods.
- PSU lodged complaint with Central Government Agencies.
- Central Government Agencies conducted search and seized various documents, information, hard disks, laptops.





Detection Techniques



Detection Techniques used

- Analysis of all physical documents, contracts, files, agreements.
- Use of Forensic tools / software viz., **CaseWare IDEA**, **EnCase Forensics**, etc. to analyze and sort out huge data like bank statements available in hard disks, storage devices.
- Tracing parties to whom huge Bank Payments amounting to US\$ 75,000 or above (INR. 0.5 MN or above) are made.
- Background check of the promoters of the company and foreign agents.
- KYC of the employees of the PSU.



Findings



Forensic Auditor spots red flags



- Four companies to whom manufacturing of jewellery contracts were given were not branded jewellers or listed companies.
- The background of the promoters were found below standard than average.
- They had no past experience in the field of manufacturing of jewellery.
- They had NPA (Non-performing assets) accounts with the banks on their loan accounts in the preceding years.
- There was no agent of PSU outside country where the goods were shipped.
- The average monthly turnover post offering 120 days' credit have been multiplied 8 to 10 times as compared to the preceding year in which there was no credit offered. Thus huge quantum of credit accumulated within credit period of 120 days itself.
- The vendors of these 4 companies were found to be in the racket of government defaulters.

Forensic Auditor spots red flags



- **Certain Red Flags were noticed further:**
 - Books of accounts were not complete and deliberately kept in chaotic conditions
 - Communication with foreign customers, agreements, accounting data
- Maintenance bill of properties (disclosed as well as undisclosed)
- **All those Red Flags helped IO in direction of further investigation and findings were:**
 - A, B, C, D was in collusion with intention of cheating PSU. Conspiracy between A, B, C, D and foreign agents was established.
 - PSU didn't check the goods in consignment.
 - Foreign Agent cleared the goods but didn't deliver it to customer.
 - A, B, C, D got double benefits i.e. 80% payment on shipment & after taking delivery of goods through their own agents, foreign currency was realized on selling goods outside India.

Recent Digital & Social Media Marketing Frauds

Ponzi Schemes

BEWARE

PONZI SCHEME

DON'T GET SCAMMED!

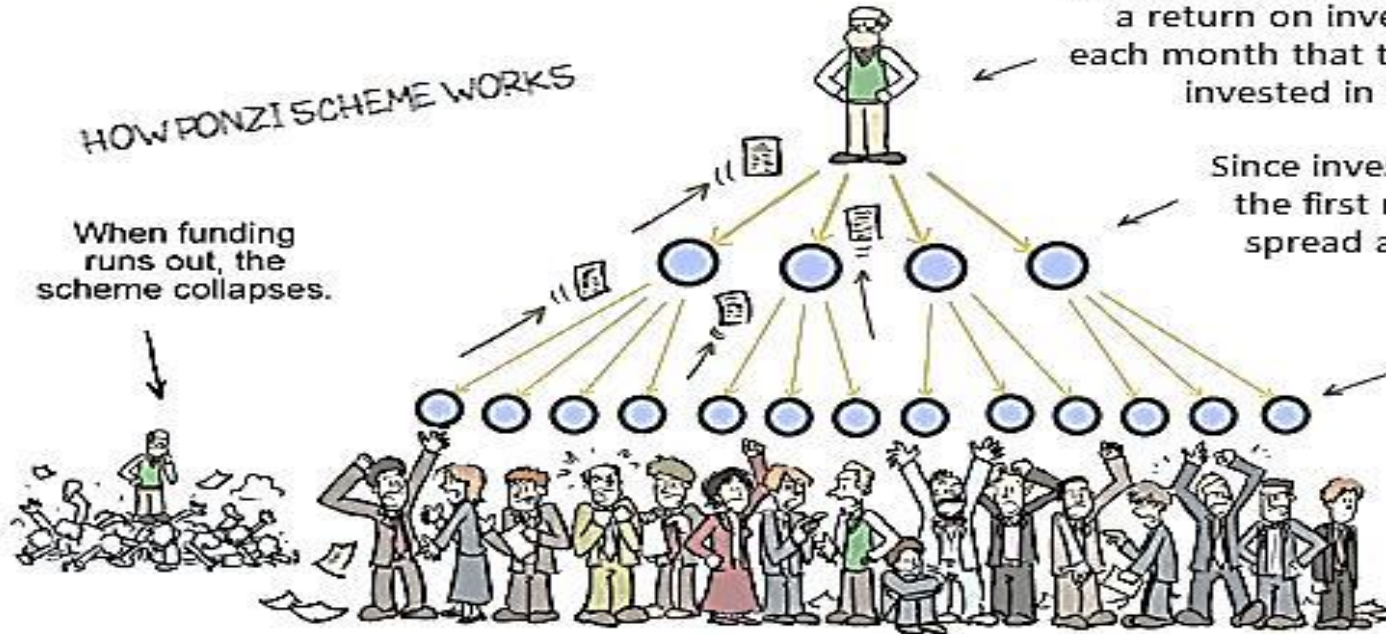
The Schemer promise investors a return on investment for each month that their money is invested in the firm.

HOW PONZI SCHEME WORKS

When funding runs out, the scheme collapses.

Since investors receives money on the first money, news started to spread and recruitment follows

Investment has been successful in the first few months, convinces more investor to place their money in the system.



Recent digital and social media marketing frauds in Asian countries are as under:

Sr. No.	Name of the scams	Year	Amount involved
1	Speak Asia	2011	US\$ 380 millions
2	Q-Net	2013	US\$ 167 millions
3	Social Trade Biz	2016	US\$ 617 millions

Details about the scam:



1. Speak Asia:

Speak Asia was an online survey marketing company which sold web subscriptions for US\$ 180 each. The investor had to fill out survey forms for multinational firms for a promised annual payment of US\$ 860. Besides, the investor could bring in more members and for each membership, claim commission and make money on the inducted member's survey forms as well. After paying a few investors at first, Speak Asia wrapped up its operations in India in mid-2011. By this time, the trio had duped more than 2.4 million investors of an estimated US\$ 380 millions.

So, what is the scheme in detail and where are its heads and tails???

Under the shade of Virgin Island, even today it is not known.

The entire matter is under investigation in the victimised countries.

Details about the scam:



2. Q-Net:

Qualification is by purchasing one product from Q-Net to suit your needs, by purchasing one of their products ranging from \$ 590 – \$ 13,050 and further making a chain of members by influencing them to purchase Q-net's products. Q-Net allegedly duped investors by selling products like magnetic disks, herbal products and holiday schemes through fraudulent practices. Q-Net has also been accused of using the banned binary-pyramid business model for their multi-level marketing (MLM) schemes to entice investors.

The entire matter is under investigation in the victimised countries.

Dream of Q-Net fraudsters

Details about the scam:

3. Social Trade Biz:

Social Trade Scam Process is as under: –

- Buy a package from social trade by paying between US\$ 95 to US\$ 950.
- Now click on daily links which you get. People got 9 cents per link click.
- Social trade gave huge commission on adding new people. It was necessary to add 2 people for booster.
- By booster, the earning of the social trade user get doubled.
- So, the people & amount kept on increasing day by day.
- Social trade did not pay the amount promised to its users.
- This was pure fraud and very simple evidence for that is it was a multi-level marketing which is illegal in India and many other countries like China and USA.
- Ponzi scheme accused were produced before court on 18.02.2017. He was sent to jail; since he duped 650K people & looted US\$ 617 MN by the Ponzi scheme floated by it.

THANK YOU!!
FOR PATIENT HEARING