



The Common Types Of Fraud, It's Causes And Impact To A Public Sector Organization

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KPMG Malaysia

Presentation Outline

- Highlights of the KPMG Fraud Survey in Malaysia
- What do we mean by fraud and misconduct
- Types of fraud in the public sector
- The root cause of fraud
- Impact of fraud to a public sector organization
- Examples of reported cases on fraud involving public servants
- Case study on fraud

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Reflections

“The annual Auditor-General’s Report invariably also highlights expenditure incurred not based on the 3Es but of 3Ps instead - Pemborosan (extravagance), Pembaziran (wastefulness) and Penyelewengan (fraud).

The three are not mutually exclusive, though. These lapses in performance would certainly cause losses to the Government and adversely impact the credibility of the Government’s delivery system.”

Tan Sri Ambrin Buang, Auditor-General of Malaysia
Excerpts from article “Value for money in public spending” 16 January 2010

Highlights of the KPMG Fraud Survey in Malaysia

Highlights of the KPMG Fraud Survey Report

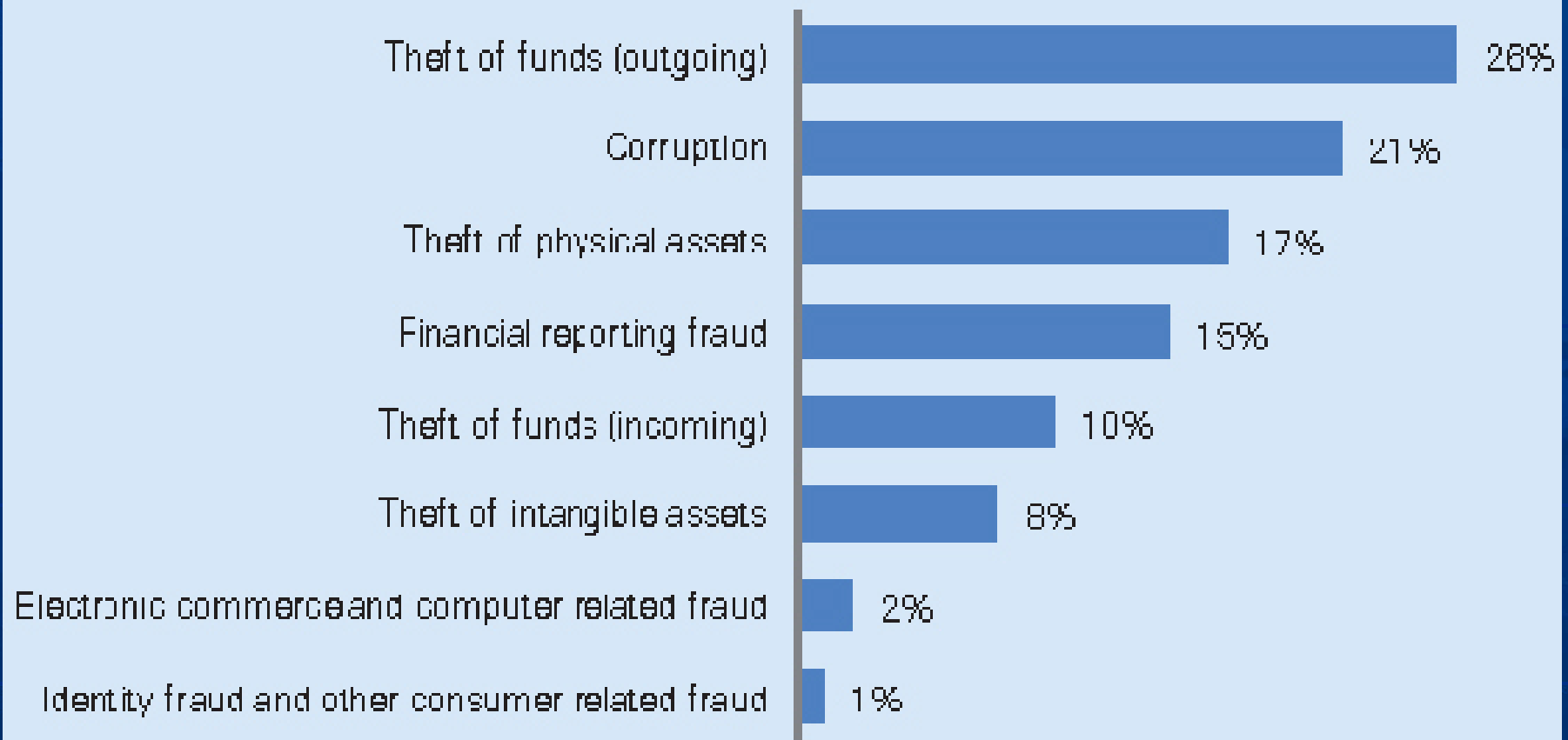
- Fraud is on the increase and continues to be a major problem for Malaysian businesses;
- Financial reporting fraud is expected to increase as a result of the current challenging business environment which has had an impact on all areas of corporate financial performance;
- Majority of fraud is perpetrated internally;
- Employees are not adequately trained to detect early warning fraud signs (“red flags”);
- Despite heavy reliance being placed on internal controls to prevent and detect fraud, poor and inadequate internal controls have failed to prevent and detect fraud;

Highlights of the KPMG Fraud Survey Report (cont'd)

- Overall most fraud was detected internally, with internal controls being the most common method followed by notification by employees, internal audit review, notification by customer/supplier and whistleblower;
- Greed/lifestyle and personal financial pressure were cited as the two most common motivations for fraud;
- Poor internal controls followed by collusion between employees and third party and poor ethical practices were the three most important factors contributing to major frauds;
- Despite the increasing risk and complexity of fraud in the current environment, many companies have not reviewed the adequacy and sufficiency of its fraud prevention strategies.

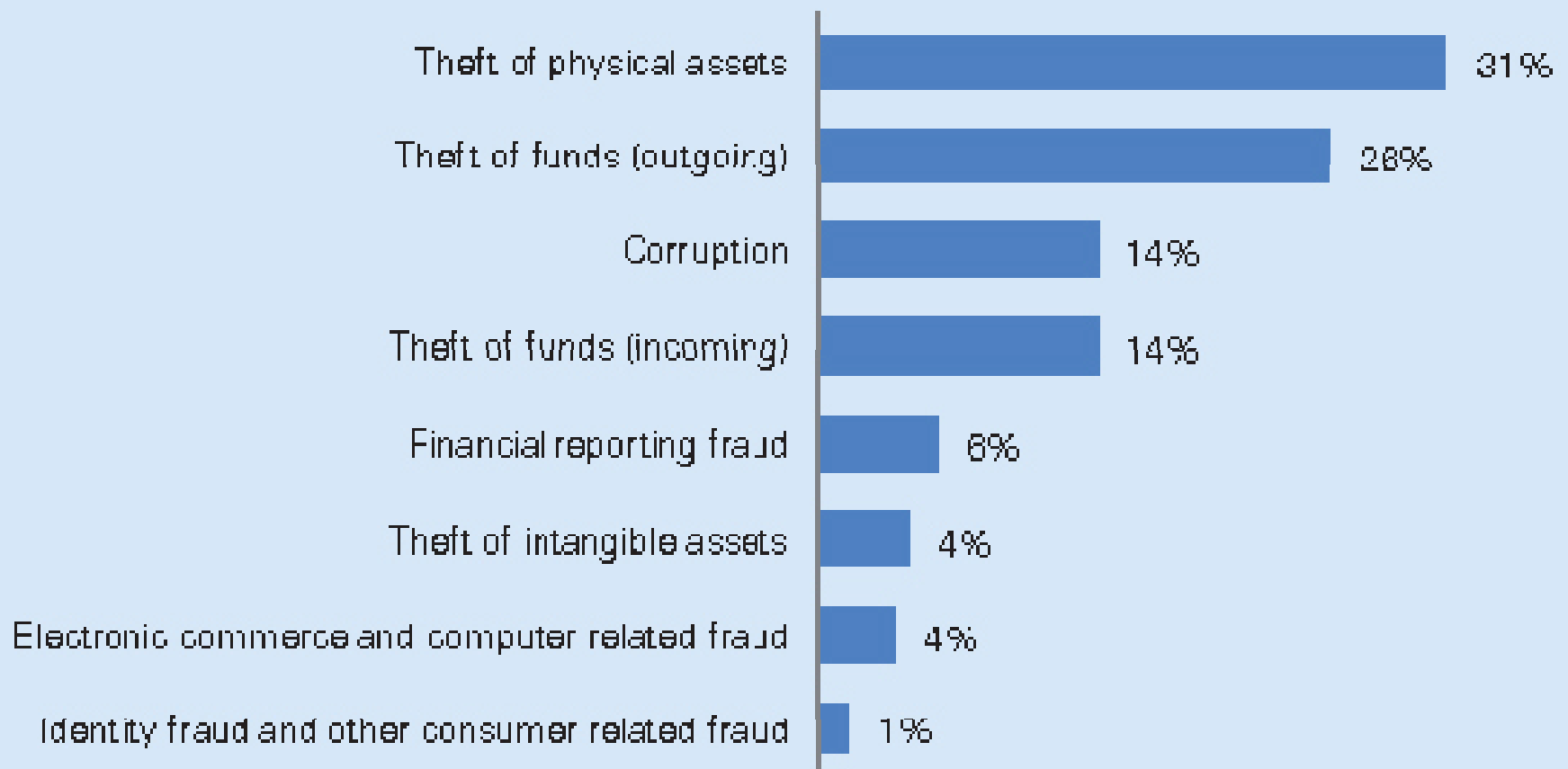
What types of fraud were committed by management level employees? KPMG Fraud Survey in Malaysia

Figure 25 - Types of fraud committed by management level employees



What types of fraud were committed by non-management level employees? KPMG Fraud Survey in Malaysia

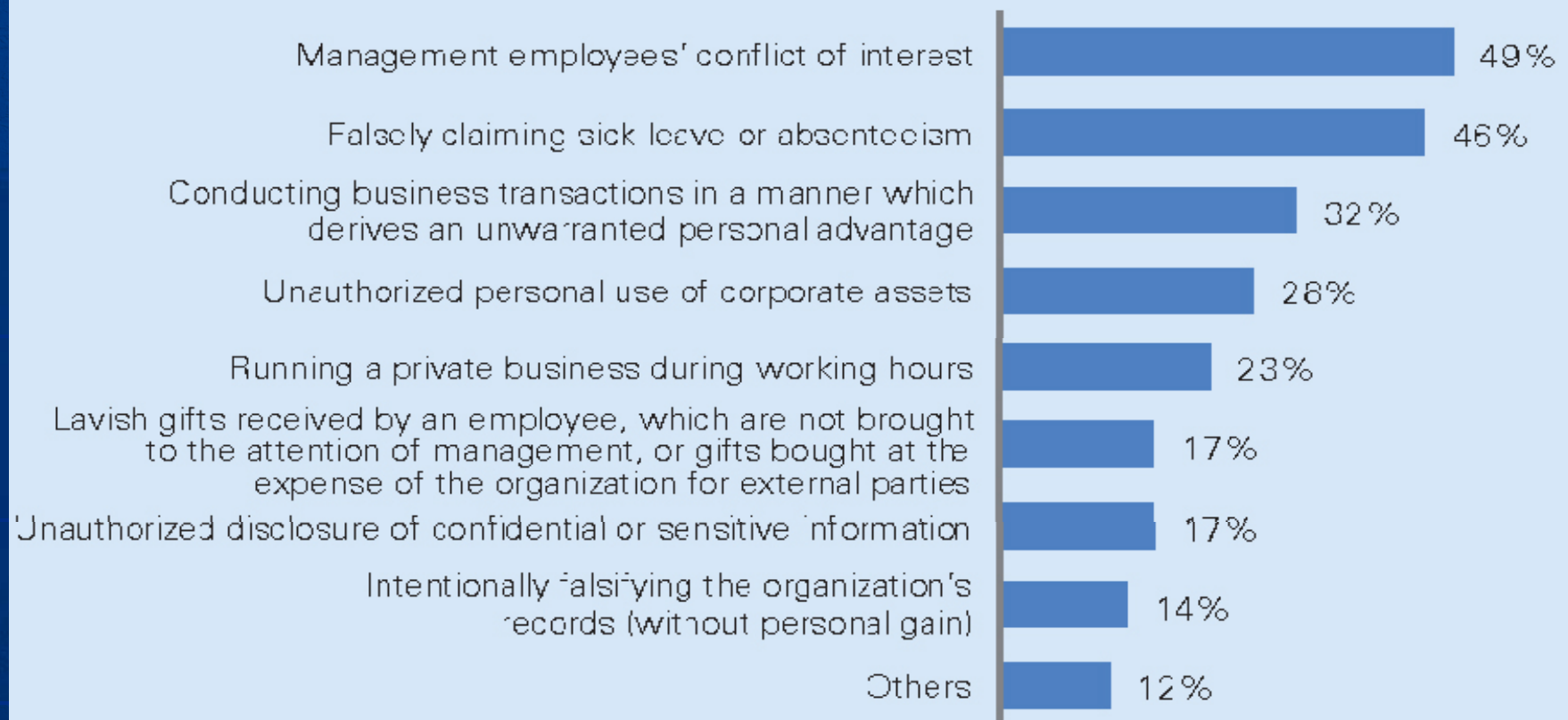
Figure 26 - Types of fraud committed by non-management level employees



How frequent are occurrences of unethical behavior within respondents' organization? KPMG

Fraud Survey in Malaysia

Figure 58 - Types of unethical behaviour or misconduct identified in the respondents' organization



**Note that some respondents indicated more than one response*

Common types of fraud in the public sector

What do we mean by Fraud and Misconduct

Fraud is a broad concept that generally refers to “any intentional act committed to secure an unfair or unlawful gain”

Misconduct is also a broad concept and generally refers to “violations of laws, regulations, policies or market expectations of ethical business conduct”

Together, they fall into the following categories of fraud schemes that can undermine **corporate integrity** and **public trust**:

Fraudulent financial reporting

- Falsification of an organization's financial statements

Misappropriation of assets

- Involves the theft or misuse of an organization's assets

Corruption

- Wrongfully using influence in a business transaction to procure some benefit to themselves or another

person, contrary to duties to the employer

Understanding Fraud in Malaysia

- Fraud usually involves some form of dishonesty, a gain by one or more persons or entities and a loss to another person or entity. Note that it is not necessary for a person to succeed (obtain the benefit) to be guilty of fraud and also that the dishonesty can be practiced by one person and the benefit derived by another.
- An example of fraud would be when a party violates or breaches the instrument of trust held by them in their fiduciary capacity by misappropriating of assets or funds entrusted to them.
- Generally fraud is covered under the Penal Code (mainly Sections 405-409, 415-420, 463-471) and other legislations (for e.g Companies Act, MACCA, CMSA, AMLA)

Common Types of Fraud and Misconduct Risks in the Public Sector

**Misappropriation
Of Assets**

**Corruption
And
Revenue /
Assets
Improperly
Gained**

**Other
Misconduct**

Common Types of Fraud and Misconduct Risks in the Public Sector (cont'd)

Misappropriation
of
Assets

Corruption
Revenue /
Assets
Improperly
Gained

Other
Misconduct

Examples of elements of Misappropriation of Assets

- Embezzlement/Breach of trust
- Misuse of assets
- Theft of equipment/inventory/supplies
- Procurement fraud
- Forgery
- Cheque fraud
- Cheating/False invoicing (fictitious payments to non-existent vendors)

Common Types of Fraud and Misconduct Risks in the Public Sector (cont'd)



Examples of elements of revenue/assets improperly gained

- Commercial or public bribery
- Kickbacks
- Abuse of power

Note: Bribery of foreign public officials under MACCA 2009, FCPA 1977 (US legislation)

Common Types of Fraud and Misconduct Risks in the Public Sector (cont'd)



Examples of Other Misconduct:

- Conflicts of interest
- Theft and leakage of proprietary/confidential information/non public information

The root cause of fraud

The Recipe for Fraud – “The Fraud Triangle”

Opportunity

“There is a weakness in the system that I could exploit”

Motive / Incentive

“I want to or have a need to commit fraud”

Rationalisation / Integrity

“I am convinced that it is worth the risks”

Why do people commit fraud?

- Some examples

Opportunity

- Internal controls are weak
- Inadequate segregation of duties
- Lack of supervision
- Too much trust

Rationalization

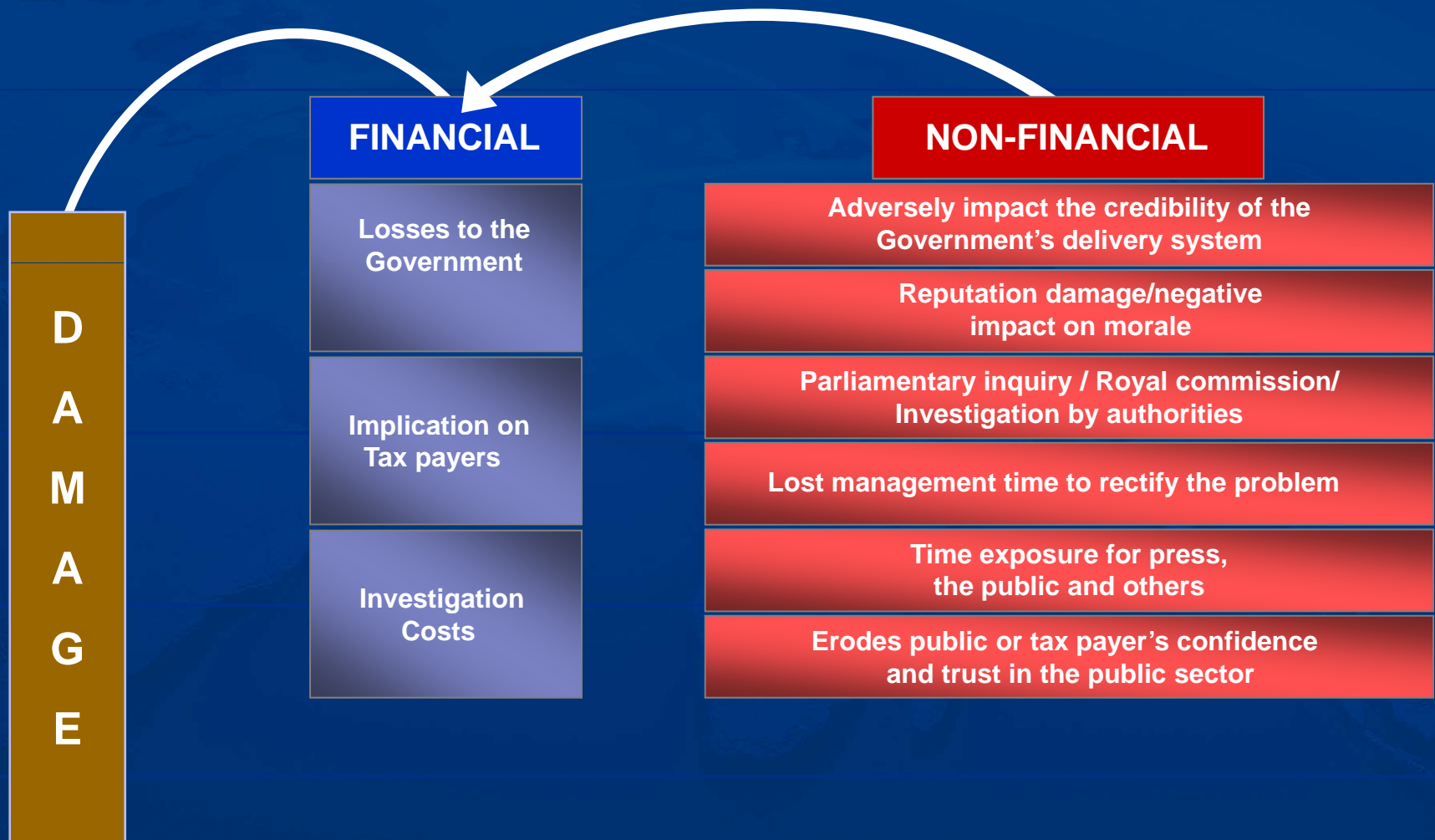
- Internal dialogue that provides the self justification for his actions
- Fraudster convinces himself that he is owed this remuneration by the employer

Motive/Incentive

- Financial pressure
- Desiring to report better than actual
- Excessive lifestyle
- Basic greed
- To maintain personal income/wealth

Impact of fraud to a public sector organization

The Damage Tree of Fraud in a Public Sector



Reported cases of public servants and semi govt agency staff charged with CBT – some examples

- 18 May 2011 – A Lieutenant Commander with the Royal Malaysian Navy was charged with allegedly making false claims using forged invoices totaling RM190,000 on board navy ship *KD Mahawangsa*
- 24 January 2007- Two former Senior GMs of Tabung Haji (TH) were sentenced to 10 years jail each for CBT of RM200m in TH funds and another 6 years jail each for deceiving 2 ministers into approving an investment of RM200m in questionable currency trading that resulted in losses of RM80m.
- 13 January 2007 - Former Amanah Ikhtiar Malaysia (AIM – an agency to help hardcore poor) MD jailed 5 years on 5 counts of CBT involving RM3.8m. He used AIM funds, without Board of Directors approval, to buy shares in MAHB, Asnita, Tabung Ittikal, Dal Al Ihsan and Dali Al Miza
- 16 November 2005 - Former Rural Development Ministry Sec. Gen was sentenced to 5 years jail for CBT involving RM9m from the hardcore poor development project fund
- 4 March 2005 – Tabung Haji clerk charged with CBT involving more than RM522,000. He was alleged to have opened a false account to deposit money and later withdrawing it.

Source: NST

Reported cases of public servants and semi govt agency staff charged with CBT – some examples (con't)

- 19 Oct 2004 – A principal asst. director of the Trust and Securities Division of the Accountant-General's office was charged with CBT amounting to more than RM922,000. The offence was allegedly committed by the accountant while attached to the Sewerage Services Dept of the Housing and Local Govt Ministry.
- 3 Sept 2004 - TNB technician Irman Shah Mohd Nor charged with CBT involving RM2million worth of equipment entrusted to him. He is alleged to have committed the offence at a warehouse in Port Klang on 27 October 2001
- 25 May 2004 – Former EPF officer Iskandar Yusuf Sobeng charged with CBT involving funds totaling RM60,000. He was alleged to have committed the offence with 2 cheques worth RM30,000 each in January and May 2001
- 18 Feb 2004 – Former PNB CEO charged with CBT involving misuse of RM460,000 for the purchase of two Proton Perdana V6, one Proton Perdana Executive 2.0 and one Inokom Permas van
- 25 July 2003 – Perlis Sports Council Director charged with 5 counts of CBT involving RM10,200

Source: NST

Case Study – Misappropriation of Assets and A/R fraud scheme

Case Study: Project X

Asset Misappropriation and A/R fraud

The 'Customer' side (A/R)

Customer A

Customer B

Customer C

The 'Intermediary'

Wanna Be Rich Sdn Bhd
(WBR)

Payment

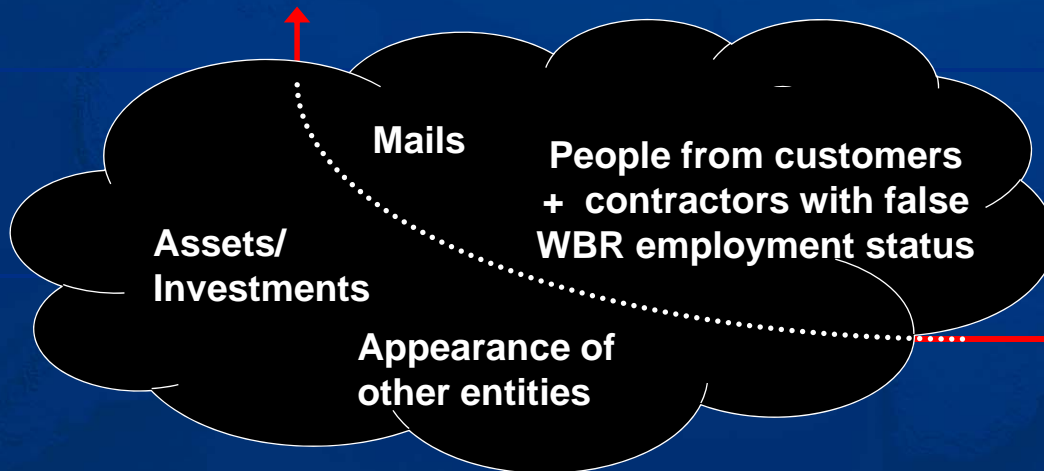
day x+75

Payment
day x

Strip Off Sdn Bhd (SO)

Deception Sdn Bhd

The 'Contractor and Supplier' side



What started as a "Ponzi scheme" under the cover of fictitious business transactions turned bad in 2009.

Case Study: Project X (cont'd)

Asset Misappropriation and A/R fraud

The 'Customer' side (A/R)

Customer A

Customer B

Customer C

Order

Invoice

Payment

The 'Intermediary'

Wanna Be Rich Sdn Bhd
(WBR)

Key Findings

- The profit margin earned by WBR from these transactions averaging approx 4%. A/R in the region of >RM100m
- Payments to SO are generally made based upon the funds available at WBR. Payment on the spot upon receipt of delivery order and invoice (COD term, i.e. cash on delivery).
- While the "turnaround time" of a customer order is negative for Customer C (i. e. WBR invoice date prior to date of customer order), the turnaround time of orders from A and B did not seem to be uncommon.
- Site visits to some of the suppliers/customers office did not reveal any business presence or commercial activities.
- Various instances of management control override with regard to A,B, C were noticed, e. g.
 - Mandatory Customer Due Diligence were not performed as part of the approval process;
 - The customer orders were not in the MRP system;
 - Extended credit terms of 75 days (instead of the usual 30 - 45 days).

Case Study: Project X (cont'd)

The 'Money Trail'

External people with WBR employment status

- Mr. A (shareholder and director of Co.A and SO)
Above individual was using office at WBR as well as business cards.
Additionally, Mr.A also had WBR e-mail address.

Appearance of other entities

- "money- changer"
- Incorporated Overseas Company

Assets/Investments of CEO WBR

- Investment funds totaling >RM 200 k
- >200,000 shares in One Company
- Shareholdings in 3 other companies

Mails

- Mail from Mr. A to CFO:
Spreadsheet attachment with projected payments to be made by Co. A and B to WBR for the upcoming 6 months.
- Mail from CEO Co. B to CFO:
SO transfers funds to an account of CEO WBR at a bank overseas.
- Various mails from CEO WBR regarding potential real estate investments.

Questions?

Presenters' contact details

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