

# **MODUL 3**

## **PENCEGAHAN DAN PENGESANAN FROD**

**Oleh:**  
**En. Ismail Johari, CFE**  
**Safetynet Services Consultant Sdn Bhd**





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## MALAYSIAN EXPERIENCE

### FRAUD CHALLENGES, DETECTION & PREVENTION

**UUM : APRIL 26 – 28, 2005**

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#### PRESENTER

**ENCIK ISMAIL JOHARI**

#### QUALIFICATION & CREDENTIALS

- MSc - Public Policy & Management in Criminal Justice System
- CFE - A Certified Fraud Examiner

**Retired from government service as:**

- Senior police officer for twenty (20) years
- A lecturer with University Kebangsaan Malaysia
- Currently manages own company – Safetynet Services Consultant Sdn Bhd – a licensed private investigator (KDN.S1739)2

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### FRAUD : CRIME OF THE 21<sup>ST</sup> CENTURY MALAYSIAN PERSPECTIVE & CURRENT SCENARIO

NOW, THE NEW MILLENIUM IS UPON US.

THERE IS NO DATE TO INDICATE THAT FRAUD AND WHITE-COLLAR CRIME HAVE ABATED. IT APPEARS TO BE JUST THE OPPOSITE – THE MORE WE LOOK FOR FRAUD, THE MORE WE FIND IT.

ACCORDING TO ESTIMATES BY ACFE (Association of Certified Fraud Examiners), OCCUPATIONAL FRAUD AND ABUSE IN USA ALONE EXCEEDED USD 400 BILLION ANNUALLY.

IN MALAYSIA, THE INCIDENT IS NOT PROPERLY ADDRESSED, THE VALUE LOSS HAS NEVER BEEN ESTIMATED BUT FOR CERTAIN – MALAYSIA IS HEAVEN FOR SUCH CRIME.

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### AXIOMS OF FRAUD CULTURES

- ☐ FRAUD & WHITE-COLLAR CRIME ARE THE CRIMES OF THE 21<sup>ST</sup> CENTURY.
- ☐ COMPUTER EVOLUTION AND INFORMATION TECHNOLOGY (IT) ADVANCEMENT BECAME AN IMPORTANT TOOL TO COMMIT CRIME.
- ☐ FRAUD COSTS ORGANIZATIONS UP TO SIX PERCENT (6%) OF THEIR REVENUE EACH YEAR.
- ☐ UNLIKE OTHER OFFENCES, PART OF THE METHODS OF FRAUD IS TO CONCEAL ITS EXISTENCE.

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### MAIN CATEGORIES OF FRAUD

The principal categories of fraud for white-collar crime are:

- ☐ MISREPRESENTATION OF MATERIAL FACTS
- ☐ CONCEALMENT OF MATERIAL FACTS
- ☐ BRIBERY
- ☐ CONFLICTS OF INTEREST/MALFEASANCE
- ☐ THEFT OF MONEY OR PROPERTY
- ☐ THEFT OF TRADE SECRETS OR INTELLECTUAL PROPERTY
- ☐ BREACH OF FIDUCIARY DUTY

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### MISREPRESENTATION OF MATERIAL FACTS

The elements normally include:

- MATERIAL FALSE STATEMENT.
- KNOWLEDGE OF ITS FALSITY.
- RELIANCE ON THE FALSE STATEMENT BY THE VICTIM; and
- DAMAGES SUFFERED

The case can be prosecuted as a CRIMINAL or CIVIL action.

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## MEANING OF CORPORATE FRUAD & ITS IMPACT TODAY

### Traditional Meaning

- General Meaning  
“Criminal deception; the use of **false representations** to gain an unjust **advantage**” (*Oxford Dictionary*)
- Common Law – Tort of Deceit
  - 1) There must be a **representation of fact** made by words or conduct.
  - 2) The representation must be made with the **intention that it should be acted upon** by the plaintiff, or by a class of persons which includes the plaintiff, **in the manner** which **resulted in damage** to him.

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## Meaning of Corporate Fraud & Its Impact Today (cont'd)

### (Traditional Meaning)

- 3) It must be proved that the plaintiff has **acted upon** the false statement.
- 4) It must be proved that the plaintiff **suffered damage** by so doing.
- 5) The representations must be made with **knowledge** that **it is or may be false**. It must be **wilfully false**, or at least made in the **absence of any genuine belief** that it is true.

*(Winfield & Jolowicz on Tort, Fifteenth Edition)*

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## Meaning of Corporate Fraud & Its Impact Today (cont'd)

(Traditional Meaning)

- **Criminal Statutory Definition** - Cheating  
Whoever by deceiving any person, whether or not such deception was the sole or main inducement:
  - i) Fraudulently or dishonestly induces the person so deceived to deliver any property to any person, or to consent that any person shall retain any property; or
  - ii) Intentionally induces the person so deceived to do or omit to do anything which he would not do or omit to do if he were not so deceived and which act or omission causes or is likely to cause damage or harm to any person in body, mind, reputation, or property.

is said to “cheat”

(Section 415, Penal Code)

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## Meaning of Corporate Fraud & Its Impact Today (cont'd)

### Wide Meaning

- Obtaining a material **advantage** by **unfair or wrongful means**; it involves moral obliquity

(Osborn's Concise Law Dictionary)

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**Meaning of Corporate Fraud  
& Its Impact Today (cont'd)**

▪ **What is Corporate Fraud?**

- A form of fraud based on the wide meaning – no authoritative and comprehensive definition.
- Take the wide meaning and apply it in the corporate world.
- A possible definition:

*“Fraud encompasses an array of irregularities and illegal acts characterised by intentional deception. It can be perpetrated for the benefit of or to the detriment of the organization and by persons outside as well as inside the organization.”*

(Corporate Fraud: Case Studies in Detection and Prevention, John D.O’Gara)

- **Generally, corporate fraud** can be defined as any act effected through unlawful or unfair means for the purposes of material gain, whether carried out within or by an organization.

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**Meaning of Corporate Fraud  
& Its Impact Today (cont'd)**

**Types of (Corporate) Fraud**

▪ **Classified into 4 categories**

- ☐ Internal misappropriation or corruption (fraud against the organization).
- ☐ Fraudulent financial reporting (fraud for the organization).
- ☐ Other fraud for the organization (various forms of bribery and corruption, money laundering, etc.)
- ☐ External fraud against the organization (e.g. credit card fraud)

(Corporate Fraud: Case Studies in Detection and Prevention,  
John D.O’Gara)

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## **Meaning of Corporate Fraud & Its Impact Today (cont'd)**

### **Examples of Corporate Fraud**

- ☐ Financial instrument fraud
- ☐ Advance fee frauds
- ☐ Stock manipulation
- ☐ Cyber crime
- ☐ False accounting
- ☐ Money laundering
- ☐ Criminal breach of trust
- ☐ Vendors' fraud

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## **Meaning of Corporate Fraud & Its Impact Today (cont'd)**

### **Types of Perpetrators**

- a) Directors
- b) Management / Employee
- c) External Third Party – include individuals.
- d) Vendors / Professionals  
– attorney and physician

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## **Meanaing of Corporate Fraud & Its Impact Today (cont'd)**

### **Negative Impacts of Corporate Fraud**

- **Impact:**

- 1) Damages and losses resulting from the fraud (suffered by the company or third party including the public)
- 2) Loss of confidence in the company/management (by investors, business associates, customers) – for policies, additional issue of share value.
- 3) Costs associated with managing the fraud.
- 4) Loss of reputation by the company.
- 5) Loss of morale within the company.
- 6) Diversion of management focus.

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## **Meaning of Corporate Fraud & Its Impact Today**

### **How Bad Is It?**

- Fraud (including corporate fraud) is on the rise.
- “Organizations are reporting a rise in fraud, responding with expanded fraud measures both reactive and prescriptive, and planning further actions for the future.” (*KPMG Fraud Survey 2003, US*)
- About half (47%) of respondents to the survey had experienced a significant fraud in the last year.  
(*Ernst & Young, Fraud: The Unmanaged Risk, 8<sup>th</sup> Global Survey*)

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## **IMPACTS OF FRAUD IN A BROADER PERSPECTIVE**

- National Security
- Public Order & Political Stability
- Loss of Revenues – government taxes.
- Individual Corporate Entity:
  - insolvency / bankrupt
  - unemployment
- Unhealthy Business Environment – discourages foreign investment.

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## **CRIME RATES VS FRAUDS**

### **In Developed Countries**

#### **CRIME INDEX CATEGORY**

- ☐ Serious and property crimes – for each reported case there would be three more unreported incidences to the Criminal Justice System (CJS).

#### **WHITE COLLAR CRIME**

- ☐ For every one case reported, there would be 100 more incidences not reported.

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### Crime Rates vs Frauds (cont'd)

#### In Malaysia

- ☐ NO RESEARCH OR SURVEY OR EVALUATION OR SCIENTIFIC STUDY HAS EVER BEEN CARRIED OUT OR CONDUCTED – KPMG HAS INITIATED THE FOUNDATION OF SURVEY IN MALAYSIA.
- ☐ NO CREDIBLE OR RELIABLE STATISTICS OF CRIME INCIDENT HAS EVER BEEN RECORDED;
- ☐ NO RELIABLE ESTIMATION OF VALUE LOSS DUE TO VARIOUS CATEGORIES OF CRIMES HAS EVER BEEN ESTIMATED;
- ☐ THE INVESTIGATION OF SOLVING RATE IS SUSPECTED OR UNDEPENDABLE;
- ☐ FOR CERTAIN, MALAYSIA IS A HEAVEN FOR CRIME.

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### Crime Rates vs Frauds – In Malaysia (cont'd)

#### White-Collar Crime

- ☐ IS ON THE INCREASING TREND;
- ☐ BECOMES MORE COMPLEX AND SOPHISTICATED ;
- ☐ CERTAIN INDUSTRIES ARE RAMPANTLY BEING TARGETED, namely:
  - I) Insurance industry
  - II) Financial institutions
  - III) Multinational corporations
  - IV) Government agencies – EPF/IncomeTax/Customs/CJS & Statutory Bodies.
  - V) Government Ministries / Departments

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## **Crime Rates vs Fraud – In Malaysia (cont'd)**

### **Why Is Fraud On The Increasing Trend ?**

- ☐ THE ENFORCEMENT IS NOT EFFECTIVE.
- ☐ FRAUD IS NOT DEALT SEVERELY ENOUGH WITH BY THE COURT OF LAW OR BY THE ORGANISATION S VICTIMIZED BY IT.
- ☐ MOST INSTANCES, HIGH "RM" FRAUDSTERS ARE CAUGHT, ONLY TO BE RELEASED WITH A SLAP ON THE WRIST.
- ☐ IN MANY INSTANCES, THE PERPETRATORS ARE ONLY FIRED, NOT PROSECUTED.

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## **COMPUTER CRIME & COMPUTER FRAUD**

- ☐ IN THIS INFORMATION TECHNOLOGY ERA, COMPUTER NOT ONLY PLAYS A DOMINANT ROLE AND HAS VERY GREAT INFLUENCE OVER THE BUSINESS CIRCLE, MANAGEMENT OR ORGANIZATION BUT ALSO EACH INDIVIDUAL BEHAVIOURAL PATTERN.
- ☐ NOT EVERYONE PUTS THEIR INTELLIGENCE, POSITION, CAPABILITY AND CREATIVE THINKING TO GOOD USE BUT MORE OFTEN THAN NOT, ABUSE THEM FOR GREED AND PERSONAL GAIN.
- ☐ COMPUTER-RELATED CRIME IS TERMED A HIGH TECHNOLOGY CRIME.

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## THE LAWS ON CORPORATE FRAUD

### Prescriptive Legislation

- Requirement for Prospectus – Security Commission Act 1993.
- Role of the Securities Commission.
- Financial Reporting – Companies Act 1965.
- Stock Manipulation.
- Insider Trading.
- Corruption – Anti Corruption Act 1997.
- General Criminal Offences (Penal Code)

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## THE LAWS

- ☐ AS FOR MALAYSIA, NO DEFINITION OF FRAUD OR WHITE COLLAR CRIME EITHER IN CRIMINOLOGY OR THE LEGAL PERSPECTIVE HAS EVER BEEN CLEARLY STATED OR SPECIFIED.
- ☐ NO SPECIFIC LAWS TO ADDRESS SUCH INCIDENT.
- ☐ THE EXISTING LAWS LACK EFFECTIVE ENFORCEMENT.

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## THE FIGHT AGAINST FRAUD

Action falls under three broad categories:

### I) FRAUD PREVENTION

- describes measures to stop fraud from occurring in the first place.

### II) FRAUD DETECTION

- involves identifying the fraud as quickly as possible once it has been perpetrated.

### III) LEGAL FRAMEWORK – to prevent corporate fraud.

NB: Apply fraud detection once fraud prevention has failed using detection method continuously.

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## LESSON FROM OTHERS

Long before WorldCom & Enron, managers were inflating and deflating the numbers to increase stock prices, earn fat bonuses, comply with loan covenants, cover-up asset misappropriations and funds for personal expenses – among other motives are:

- ☐ INTENTIONAL MISSTATEMENT OF BECOMING THE FASHIONABLE FRAUD OF 2002.

**IS THIS THE SAME SCENARIO IN MALAYSIA? THE POSSIBILITY COULD NOT BE RULED OUT.**

- ☐ ALWAYS BLAME EXTERNAL FORCES, SELDOM LOOK INTO INTERNAL CRISIS FACTORS – ABUSE & FRAUD.

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### **Lesson From Others (cont'd)**

#### **IN USA**

**WHEN MONOLITHIC CORPORATION CRUMBLES DUE TO  
FRAUD AND AVERAGE CITIZENS LOST THEIR JOBS &  
PENSIONS, CONGRESS STEPPED INTO THE GAP AND  
CREATED THE "SARBANES-OXLEY ACT OF 2002"**

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### **Lesson From Others (cont'd)**

#### **SARBANES-OXLEY ACT**

Sarbanes-Oxley Act or better known as SOX is intended to:

- ☐ IMPROVE CORPORATE ACCOUNTABILITY
- ☐ IMPROVE CORPORATE RESPONSIBILITY
- ☐ IMPROVE FRAUD DETECTION
- ☐ IMPROVE FRAUD PREVENTION, and
- ☐ REASSURE INVESTORS THAT IT IS SAFE TO INVEST IN STOCK MARKET.

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### **Lesson From Others (cont'd)**

#### **IN AUSTRALIA**

- ☐ A NEW AUDITING STANDARD "AUS 210" IS INTRODUCED TO HOLD MANAGEMENT RESPONSIBILITY FOR THE DETECTION AND PREVENTION OF FRAUD.
- ☐ "AUS 210" REQUIRES MANAGEMENT TO PROVIDE THE INDEPENDENT AUDITOR TO IMPLEMENT CONTROL SYSTEM DESIGNED TO MITIGATE FRAUD.
- ☐ MANAGEMENT COULD BE HELD ACCOUNTABLE IF PREVENTION PROGRAMS ARE NOT IN PLACE BUT FRAUD OCCURS.

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### **Lesson From Others (cont'd)**

#### **IN MALAYSIA**

- ☐ INTRODUCED CODE ON CORPORATE GOVERNANCE 2002.
- ☐ THE CODE ESSENTIALLY AIMS TO SET OUT PRINCIPLE AND BEST PRACTICES STRUCTURES AND PROCESSES THAT COMPANIES MAY USED TO ENSURE OPTIMAL GOVERNANCE FRAMEWORK IS ACHIEVED.

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**OECD PRINCIPLES  
OF CORPORATE GOVERNANCE 2004**

- ☐ O.E.C.D. - ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT.
- ☐ SET UP TO ASSIST OECD & NON-OECD GOVERNMENTS IN THEIR EFFORTS TO EVALUATE AND IMPROVE THE LEGAL, INSTITUTIONAL AND REGULATORY FRAMEWORK FOR CORPORATE GOVERNANCE IN THE INDIVIDUAL COUNTRY.

MALAYSIA IS AN "OECD" MEMBER.

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**PLAN TO DETECT & PREVENT FRAUD  
(PROPOSAL – SAFETYNET)**

- ☐ WITH THE CORPORATE GOVERNANCE'S SPIRIT AND VALUES, MALAYSIA SHOULD HAVE HER OWN COMPOSITE MODEL – A PLAN TO DETECT AND PREVENT FRAUD.
- ☐ TODATE, WE HAVE NONE. OFFENCES ARE TREATED BY EACH INDIVIDUAL ENFORCEMENT AGENCY.
- ☐ FRAUD IS A BUSINESS RISK TO BE MANAGED IN THE SAME WAY AS ANY OTHER BUSINESS OR FINANCIAL RISK.
- ☐ INVESTIGATION SHOULD BE PARTICULARLY INDEPENDENT, FREE FROM EXTERNAL INTERFERENCES.

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### Plan to Detect & Prevent Fraud (cont'd)

Fraud Prevention and Control Model should achieve any or all of the following five primary objectives:

- |   |   |  |
|---|---|--|
| <input type="checkbox"/> PREVENTION                             | : | Stop incident of fraud from occurring.   |
| <input type="checkbox"/> DETERRENCE                             | : | Deter potential fraudsters from even attempting fraudulent activity.   |
| <input type="checkbox"/> DISRUPTION                             | : | Make life as difficult as possible for the fraudsters and keep them on the move and under pressure.  |
| <input type="checkbox"/> IDENTIFICATION                         | : | A good fraud prevention will help identify high risk activities and weaknesses in the controlled environment.  |
| <input type="checkbox"/> CIVIL ACTION/<br>CRIMINAL PROSECUTION: | : | Effective strategies will reduce the likelihood of needing to resort to costly civil actions or time consuming and disruptive police investigations. |

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### COMPOSITE MODEL – PROPOSAL (CM-P)

- ☐ CONSIDER FRAUD RISK AN INTEGRAL PART OF AN OVERALL CORPORATE RISK MANAGEMENT STRATEGY.
- ☐ FRAUD IS AS MUCH OF A THREAT TO AN ENTITY AS CHANGES IS TO LEGISLATION, COMPETITOR ACTION OR INFLATION.
- ☐ IN OVERALL EFFECT THEREFORE NEEDS TO BE FULLY UNDERSTOOD AND MANAGED ACCORDINGLY.
- ☐ DEVELOP AN INTEGRATED STRATEGY FOR FRAUD PREVENTION & CONTROL.

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### CM – P (cont'd)

- ☐ EVERY ORGANIZATION SHOULD POSSESS AN INTEGRATED STRATEGY FOR FRAUD PREVENTION AND CONTROL IN ORDER TO DRAW ALL ELEMENTS OF THE STRATEGY TOGETHER TO FORM A HOLISTIC AND COMPLEMENTARY RAFT OF FRAUD COUNTER MEASURES.
- ☐ DEVELOP OWNERSHIP STRUCTURE WHICH CRUSADES DOWN THROUGHOUT THE ENTITY.
- ☐ FRAUD PREVENTION IS EVERYONE'S RESPONSIBILITY BUT TOP MANAGEMENT'S ACCEPTANCE AND OWNERSHIP IS ESSENTIAL IF THE STRATEGY IS TO WORK.

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### CM – P (cont'd)

- ☐ SPECIFIC OWNERSHIP RESPONSIBILITIES MAY ALSO BE PLACED ON INDIVIDUAL MANAGERS OR ON INTERNAL AUDIT DEPARTMENT.
- ☐ INTRODUCE A FRAUD POLICY STATEMENT TO EMPHASIZE THE ORGANIZATION'S ATTITUDE TO FRAUD IN MANY GUISE, ITS DETERMINATION TO COMBAT AND PREVENT FRAUD & A COMMITMENT TO PUNISHING THOSE FOUND GUILTY OR WRONGDOING.
- ☐ IT SHOULD BE SIMPLE, FOCUSED AND EASILY UNDERSTOOD BY ALL MEMBERS STAFF.

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### CM – P (cont'd)

☐ **INTRODUCE AN ETHICS POLICY.**

- THE ETHIC STATEMENT SUPPORTS THE FRAUD POLICY STATEMENT. IT SHOULD BE A CODE OF BUSINESS CONDUCT EMPHASIZING THE NORMS / VALUES EXPECTED IN DAILY ACTIVITY.
- PROMOTE THE POLICY TO BE OBSERVED AND ADHERED.

☐ **ESTABLISH A SOUND CONTROL ENVIRONMENT.**

- SENIOR MANAGEMENT NEEDS TO LEAD BY EXAMPLE AND TO PROVIDE THE RIGHT DIRECTION.

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### CM – P (cont'd)

☐ **ESTABLISH A SOUND OPERATIONAL CONTROL PROCEDURE:**

- MANAGERS ESTABLISH DOCUMENTS & EXECUTE POLICIES AND PROCEDURES TO COUNTER IDENTIFIABLE RISK AND TO ACHIEVE BUSINESS OBJECTIVES - AUTHORIZATION CONTROLS, SEGREGATION OF DUTIES, ETC.

☐ **INTRODUCE FRAUD EDUCATION, TRAINING & AWARENESS PROGRAMME.**

- THE STAFF SHOULD BE MADE AWARE OF THE GENERAL RISK OF FRAUD FROM INTERNAL & EXTERNAL THREATS.
- THE STAFF NEED TO BE EDUCATED ON SPECIFIC THREATS FACING THEM.
- THE STAFF NEED TO BE TRAINED TO UNDERSTAND THE FRAUD INDICATORS & RED FLAGS.

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### CM – P (cont'd)

☐ **INTRODUCE FRAUD RESPONSE PLAN:**

- TO REDUCE THE LIKELIHOOD OF PANIC AND ENSURE THAT STAFF MEMBERS AT ALL LEVELS UNDERSTAND WHAT IS REQUIRED OF THEM, THAT EFFECTIVE ACTION IS TAKEN AND THE SECURITY AND INTEGRITY OF EVIDENCE IS GUARDED TO LIMIT THE DAMAGE CAUSED BY FRAUD.

☐ **INTRODUCE "WHISTLE-BLOWING" POLICY:**

- TOP MANAGEMENT POSITIVELY ENCOURAGES PEOPLE TO COME FORWARD AND REPORT INSTANCES OF FRAUD & MALPRACTICES.
- THE POLICY SHOULD ALSO IDENTIFY REPORTING PROCEDURES & ASSURANCE OF PROTECTION OF THE WHISTLE BLOWER'S IDENTITY.

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### MONITORING SYSTEM

Develop:

- 1) Fraud indicators
- 2) Red Flags – related to service / industries.
- 3) Check lists for staff's quick references.

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**CATEGORIES OF INVESTIGATION PROVIDER**  
(Differences – Malaysian Experience)

**Fraud Examination or Safetynet's Investigation**

- Comprehensive with details.
- Specific and establish proof.
- Establish criminality and scrutinize all potential wrongful acts.
- To uncover and identify the criminal intent and act.
- Properly manage investigative process.
- Make appropriate recommendations based on findings.
- Adversarial – involves efforts to affix blame.

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**Categories of Investigation Provider (cont'd)**  
(Differences – Malaysian Experience)

**Police Investigation**

- Reliant on police reports.
- Room for plea bargaining with focus to prosecute and convict the suspect with less concern for the victim's interest, even though there are legal provisions of such interest.
- Identify and arrest suspect (s).

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**Categories of Investigation Provider (cont'd)**  
(Differences – Malaysian Experience)

**Investigative Audit**

- Investigation in compliance with policy.
- Make recommendations for management to undertake rectification or prevent future occurrence.
- Non-adversarial.

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**About**  
**SAFETYNET SERVICES CONSULTANT (SSC)**

SSC is a Home Ministry licensed organization dedicated to assist clients in addressing fraud problems by professionally investigating suspected crime and fraud incidents.

SSC todate has been involved and resolved numerous fraud related cases, serving many clients including listed & private companies, professional firms, multinationals companies and individuals.

SSC also provides consultancy on fraud prevention and training services.

SSC also sets out to help prevent cancerous threats that continuously incur losses due to undetected covert activities of fraudsters at the expense of companies' profits and interests.

Our **MOTTO** is: ***"One Way To Make Money Is To Stop Losing It"***

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**Thank You**

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