



**Strathmore**  
UNIVERSITY

**STRATHMORE BUSINESS SCHOOL**

MASTER OF COMMERCE

END OF SEMESTER EXAMINATION

**MCOM 8204: FRAUD RISK MANAGEMENT**

**Date:** Monday 1<sup>st</sup> August 2022

**Time:** 3 Hours

---

**Instructions**

1. This examination consists of **FIVE** questions.
2. Answer **QUESTION ONE** and **ANY OTHER TWO** questions.

**Question 1 (30 marks) (Compulsory)**

**Required:**

Read the case study titled “Houston we have a problem: They paid themselves bonuses!” and attempt the questions below:

- a) The COSO Internal Control – Integrated Framework and Fraud Management Guide define fraud and identify four categories of fraud: 1) fraudulent financial reporting; 2) fraudulent non-financial reporting; 3) misappropriation of assets; and 4) other illegal acts and corruption. Discuss whether the events surrounding the bonus payout at VPC suggest a fraud should be suspected, and if so, the type(s) of fraud it would be. **(5 marks)**
- b) Principle 8 of the COSO Internal Control – Integrated Framework requires the appropriate level of management to assess fraud risk by considering incentives and opportunities to commit fraud, as well as attitudes and rationalizations. Looking at the events surrounding the bonus payout with the benefits of hindsight, use the guidance found in the COSO Framework to identify and discuss factors present at VPC that are indicative of each of the three types of fraud risk factors. **(4 marks)**
- c) Principle 8 of the COSO Internal Control – Integrated Framework also requires the appropriate level of management to assess the risk of management override of controls. Use the guidance found in the COSO Framework to discuss whether Michael and Peter appear

to have overridden internal controls to payout the bonuses at VPC. **(6 marks)**

- d) Chapter 4 of COSO's Fraud Management Guide discusses the steps that should be taken by the organization to investigate and address allegations of fraud. When Ken ends his phone conversation with Amanda, he tells her he wants to speak with his partners first and that he will get back to her shortly. Use the guidance found in Chapter 4 of the Guide to identify his potential courses of actions and discuss what the next steps should be if Houston and/or Jersey decide to further investigate the unauthorized bonus payout. **(5 marks)**
- e) Internal control remediation is one of the corrective actions discussed in Chapter 4 of COSO's Fraud Management Guide to reduce the risk of similar fraud occurring and/or going undetected in the future. Fraud control activities are discussed in Chapter 3 of the Guide. To prevent and/or detect senior management fraud, the board of directors needs to have in place a strong control environment that holds senior management accountable and minimizes their ability to override controls. Use the guidance found in the guide to recommend changes to VPC's control environment that should be considered by Houston and Jersey to prevent and/or detect future unauthorized bonus payouts. **(5 marks)**
- f) The case ends with Amanda wondering what she should do next. Identify at least 3 potential courses of action for Amanda and discuss some pros and cons of each. What would you do if you were Amanda, and why? **(5 marks)**

## **Question 2 (15 marks)**

Building on the Orotavia Municipality case discussed extensively during class, you are required to perform a detailed fraud risk assessment given the scenario below:

### **Orotavia Municipality Human Resources Department**

The municipality staff of Orotavia is dominated by supporters or family and friends of the ruling party - League for Citizens Prosperity. The Human Resources function in Orotavia is responsible for hiring, training, and developing the staff of Capital and some of its related ventures, e.g. office issuing ID cards, city parking controllers, and municipal police. The City public transport company, utility companies, and most schools and city hospitals have their own HR functions.

Department heads have the best understanding of the workload and future changes in their units, which require new hiring. Department heads request hiring of new staff as required, informing HR of the role and outline responsibilities of the new hires. The HR department drafts in detail the range of responsibilities, describes expectations from the candidates (including formal education requirements), and describes the conditions of hiring. This set of documents is then sent back to department heads for final review. Department heads update the documents if needed (and send back to HR for changes). If no further changes are required, department heads give their go ahead

and the HR Department seeks approval for the new position/replacement from the Mayor (or his Deputy in the Mayor’s absence). When the Mayor (or Deputy) is satisfied with the justification obtained from the department head, he/she sends back the signed request to the HR Department (paper approval). Based on this formal approval, HR starts the hiring process: the job announcement is posted on Orotavia’s web page with clear requirements of the job, expectations from the candidates, and giving the final deadline for applications. The information regarding expected salary is not disclosed.

**Required**

Perform a detailed fraud risk assessment of Orotavia’s Human Resources function using the following additional information necessary for the assessment:

<b>Likelihood</b>				
<b>Rating</b>	<b>Based on Annual Frequency</b>		<b>Based on Annual Probability of Occurrence</b>	
	<b>Descriptor</b>	<b>Definition</b>	<b>Descriptor</b>	<b>Definition</b>
5	Very frequent	More than twenty times per year	Almost certain	>90% chance of occurrence
4	Frequent	Six to twenty times per year	Likely	65% to 90% chance of occurrence
3	Reasonably frequent	Two to five times per year	Reasonably possible	35% to 65% chance of occurrence
2	Occasional	Once per year	Unlikely	10% to 35% chance of occurrence
1	Rare	Less than once per year	Remote	< 10% chance of occurrence
<b>Significance</b>				
<b>Rating</b>	<b>Descriptor</b>	<b>Definition</b>		
5	Catastrophic	· Financial loss to company in excess of \$10 million		
		· International, long-term media coverage		
		· Widespread employee morale issues and loss of multiple senior leaders		
		· Required to report incident to authorities, resulting in significant sanctions and financial penalties		
4	Major	· Financial loss to company between \$100,000 and \$10 million		
		· National, long-term media coverage		
		· Widespread employee morale problems and turnover		
		· Required to report incident to authorities, resulting in sanctions against company		

3	Moderate	· Financial loss to company between \$10,000 and \$100,000
		· Short-term, regional or national media coverage
		· Widespread employee morale problems
		· Required to report incident to authorities and take immediate corrective action
2	Minor	· Financial loss to company between \$1,000 and \$10,000
		· Limited, local media coverage
		· General employee morale problems
		· Incident is reportable to authorities, but no follow-up
1	Incidental	· Financial loss to company less than \$1,000
		· No media coverage
		· Isolated employee dissatisfaction
		· Event does not need to be reported to authorities
<b>Control Effectiveness</b>		
<b>Control Risk Rating</b>	<b>Description</b>	
5	Very effective (reduces 81–100% of the risk)	
4	Effective (reduces 61–80% of the risk)	
3	Moderately effective (reduces 41–60% of the risk)	
2	Marginally effective (reduces 21–40% of the risk)	
1	Not effective (reduces 0–20% of the risk)	

**Question 3 (15 marks)**

Karen L. Baer pleaded guilty to bank fraud in connection with a scheme to steal what the FBI reported to be over \$1 million from the bank where she worked. According to her guilty plea, from 1998 until her termination on October 25, 2007, Baer was a teller at PNC Bank or one of its predecessors, Westminster Union Bank or Westminster Bank, which had both been acquired by Mercantile Bankshares in 1972. PNC acquired Mercantile in 2007. Baer was the teller supervisor of one of PNC’s shopping center branches at the time of her termination. Beginning in June 2002, Baer stole cash from the branch on a monthly basis in amounts of \$10,000 at a time. To conceal her thefts, she made false entries in an account named “Due from Mercantile” by creating false debit and credit tickets designed to document cash shipments sent from her branch to the Federal Reserve and cash shipments received by the branch from the Federal Reserve. According to court documents, Baer made at least several hundred bogus debits and corresponding credits in order to

make her initial theft difficult to detect and to hide additional thefts. The FBI, which investigated the case stated that over the course of her scheme, the debits and credits totaled \$1,050,000. Amazingly, Baer's conduct was not uncovered until nearly six years after she started stealing, when PNC began an audit in September 2007 in connection with its acquisition of Mercantile. Had the merger been blocked by regulators, chances are the scheme would have continued indefinitely. Fortunately, however, PNC's auditors finally did discover the \$1,050,000 in missing cash. Further investigation revealed the pattern of suspect debit and credit tickets signed by Baer. In October 2007, when a PNC investigator confronted Baer concerning these allegations, she admitted that she had been stealing cash from her teller drawer since 2002.

**Required:**

- a) Assume you had been hired as an investigator in the above case. What are some of the recommendations you would make to PNC Bank to reduce the likelihood of this form of employee fraud? **(10 marks)**
- b) Briefly describe 2 fraud risk management frameworks that PNC Bank could use to mitigate their exposure to different forms of fraud. Provide a rationale for your selected frameworks given the case. **(5 marks)**

**Question 4 (15 marks)**

BJT is a luxury fashion brand that produces bespoke clothing for women with materials sourced from Ghana, Nigeria and Côte d'Ivoire. One of the company's primary strengths is its brand name. BJT must constantly assure that its products are of the highest quality and must invest in research and development to continually improve its products. BJT has growing brand awareness within the East African market. BJT uses social media monitoring tools to assess its brand awareness. Brand awareness is considered to be a critical determinant of BJT's growing presence in its chosen target market. BJT monitors four media channels, namely its blog, social media accounts (i.e. LinkedIn, Twitter, Facebook and Instagram), online newspaper and associated press. Assume you have been hired as a consultant for BJT.

**Required:**

- a) Identify potential reputational risks that BJT may encounter in their line of business. **(5 marks)**
- b) Provide detailed recommendations on how BJT can manage its reputational risk. **(10 marks)**