



STRATHMORE BUSINESS SCHOOL
BACHELOR OF FINANCIAL SERVICES
END OF SEMESTER EXAMINATION

BFS 3202: FINANCIAL SERVICES FRAUD AND INVESTIGATIONS

DATE: Tuesday, 17th December 2024

TIME: 13:00 – 15:00

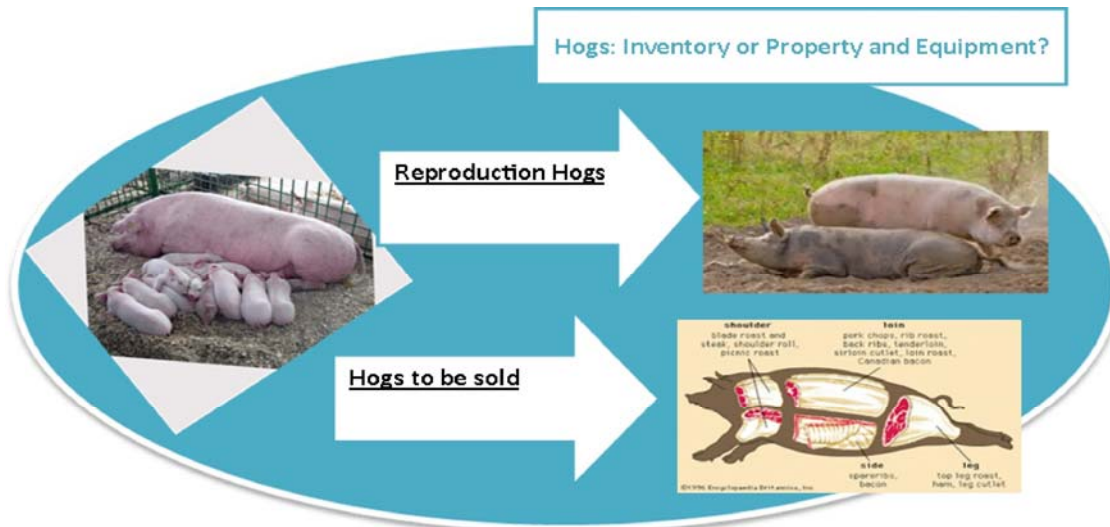
Instructions

1. This examination consists of **FIVE** questions.
2. Answer **Question ONE (COMPULSORY)** and any other **TWO** questions.

QUESTION ONE

(30 MARKS)

In March of 2014, the SEC charged six AgFeed Industries, Inc., top executives with overstating revenues. The alleged overstatements occurred between the years of 2008 and 2011 and totaled about \$239 million. This alleged fraud caused revenues to be overstated by 71 to 103 percent, annually. AgFeed operates in the United States and China with two main businesses: (1) animal nutrition (mainly animal feed) and (2) hog (swine) production. The hog production business was just that, hogs were maintained to produce more hogs. The offspring were fattened up and sold



down the supply chain to packaging companies and slaughterhouses. AgFeed classified hogs used for reproduction as Property and Equipment, because the hogs were long-term in nature and used in current operations to generate revenue. The cost of the reproduction hogs were subject to annual depreciation. Hogs to be sold were classified as Inventory. In order to show more revenue than the company actually earned, AgFeed created fictitious purchases of reproduction hogs. Instead of recording a decrease in Cash or an increase in A/P, AgFeed offset the purchase by increasing revenues. The company maintained two sets of accounting records to hide the fraud.

Required: Answer the following questions in relation to the above case:

- i. Which of AgFeed's accounts, if any, were affected by this fraud? **(4 marks)**
- ii. Which of AgFeed's financial statements, if any, were affected by this fraud?
Solution. **(6 marks)**
- iii. Why are the hogs sometimes classified as fixed assets and sometimes classified as inventory? **(4 marks)**
- iv. What could the external auditors have done to detect the fictitious purchase of hogs? **(4 marks)**
- v. What is the difference between Depreciation Expense and Accumulated Depreciation? **(3 marks)**
- vi. Why is 3.5 years an estimate of the reproduction hogs' useful lives? **(3 marks)**
- vii. What is book value, and how does it differ from fair value? **(3 marks)**
- viii. What details are provided in the Financial Statements related to Property and Equipment? **(3 marks)**

Adapted from Marshall and Bolt-Lee (2016), "Fraud Mini-Cases: An Active Learning Pedagogy to Enhance Student Competencies In Financial Accounting Principles", *Global Perspectives on Accounting Education*, Vol. 13, 51-79

QUESTION TWO

(20 MARKS)

Case Study:

ABC Bank, a mid-sized commercial bank in Kenya, has recently been hit by a significant fraud scandal. Over the course of six months, fraudulent activities were carried out by both external and internal actors. These activities included unauthorized access to customer accounts, falsification of financial documents, and money laundering schemes involving local and international transactions.

The fraud came to light when a customer reported unusual transactions from their savings account. An internal investigation by ABC Bank's compliance department revealed that several employees had colluded with external fraudsters. The employees involved in the scheme exploited weaknesses in the bank's Know Your Customer (KYC) and Anti-Money Laundering (AML) controls. The total financial loss amounted to KES 100 million, and the bank's reputation suffered significant damage, leading to a loss of customer trust and a drop in share value.

Further investigation revealed that ABC Bank had not fully complied with Kenya's Proceeds of Crime and Anti-Money Laundering Act (POCAMLA), which requires financial institutions to monitor and report suspicious transactions to the Financial Reporting Centre (FRC). The Central Bank of Kenya (CBK) is now scrutinizing ABC Bank for failing to uphold the regulatory and legal standards required of financial institutions.

Required:

- i. Identify and describe at least **three** different types of fraud evident in the ABC Bank case. **(6 marks)**
- ii. Discuss the potential impact of this fraud on ABC Bank's operations, reputation, and financial performance. **(6 marks)**
- iii. Explain the legal and regulatory frameworks in Kenya that ABC Bank failed to comply with in this case? **(8 marks)**

QUESTION THREE**(20 MARKS)**

Scenario: You are a financial analyst in charge of monitoring the internal compliance systems of a mid-sized financial institution. Recently, the institution was notified by the Financial Intelligence Unit (FIU) about suspicious transactions involving multiple layers of entities across different jurisdictions. These transactions have sparked concerns of a possible money laundering scheme, involving trade-based money laundering (TBML), which is structured to conceal the origin of illicit funds. Despite existing compliance monitoring, these transactions went unnoticed for an extended period. The institution uses traditional methods for fraud detection but has not yet fully integrated advanced data analysis or pattern recognition tools into their operations. The board has tasked you with investigating the case and identifying where the gaps in fraud detection occurred, proposing ways to improve the system.

Required:

- i. You are tasked with investigating a potential case of trade-based money laundering (TBML). Describe how you would apply specific data analysis techniques (e.g., regression analysis, data mining) to investigate cross-border transactions for discrepancies that may signal TBML. **(8 Marks)**
- ii. Explain the role of pattern recognition in detecting fraudulent activity. Discuss the types of patterns you would expect to find in cases of money laundering, particularly TBML, and describe how you would integrate pattern recognition technologies into the institution's existing fraud detection systems to prevent similar cases from occurring in the future. **(6 Marks)**
- iii. Assess the current compliance monitoring system and discuss why it may have failed to detect the money laundering scheme. Based on the case, propose improvements to the compliance system, focusing on the integration of advanced fraud detection tools like real-time transaction monitoring, suspicious activity alerts, and automated reporting to regulators. **(6 Marks)**

QUESTION FOUR**(20 MARK)**

Scenario: You are part of the fraud investigation team at a multinational financial institution. A recent internal audit has revealed several discrepancies in the financial statements of a subsidiary located in a high-risk jurisdiction. There are suspicions that senior management may be involved in misappropriating funds through a series of falsified invoices and fictitious vendor accounts. The Board has tasked your team with conducting a thorough fraud investigation to determine the scope and identify those responsible.

Required:

- i. Upon discovering potential fraud at a multinational financial institution, outline the key steps you would take to initiate the fraud investigation. Your answer should cover: stakeholder involvement, legal compliance, initial data gathering, and communication protocols with internal departments and external regulators. **(4 Marks)**
- ii. Describe the methods you would use to collect data and gather evidence during the investigation. In the context of forensic accounting, which financial documents would you prioritize for analysis, and how would you use AML software tools to verify the legitimacy of these documents? **(4 Marks)**

- iii. Once the financial data has been collected, outline the techniques you would apply to analyze the data for signs of fraud. How would you use forensic accounting methods to identify patterns of misappropriation, and what red flags would you look for in the financial statements? **(4 Marks)**
- iv. Describe the approach you would take when interviewing suspects and witnesses during the fraud investigation. What strategies would you employ to obtain accurate and truthful information from those involved? How would you handle potential resistance or reluctance from key individuals? **(4 Marks)**
- v. After completing the investigation, explain how you would compile the findings into a report for the Board. What information would be crucial to include in the report, and how would you present your recommendations for preventing future fraud? Discuss any follow-up actions that may be necessary after concluding the investigation. **(4 Marks)**

QUESTION FIVE

(20 MARK)

Scenario: You are a fraud investigator at a mid-sized financial institution. An internal investigation has revealed that a senior employee in the procurement department has been inflating vendor invoices and approving payments to fictitious companies. The Board has requested a detailed fraud investigation report that documents the entire investigation process, from the discovery of the fraud to the final findings and recommendations. You are tasked with preparing the investigation report and ensuring that all relevant information and supporting evidence are clearly presented.

Required:

- i. Describe how you would document the initial discovery of the fraud. What key information would you include in this section of the report, and why is it important for the overall investigation? Discuss the types of evidence that should be referenced to substantiate the initial discovery. **(4 Marks)**
- ii. Explain how you would structure the section of the report that details the steps taken during the investigation. How would you ensure that the investigative process is clearly communicated to stakeholders? Include details on how evidence was collected, who was interviewed, and how findings were validated. **(4 Marks)**
- iii. Provide an outline for summarizing the findings of the investigation in the report. What key elements should be included to ensure that the findings are comprehensive and actionable? Discuss how you would present the evidence in a clear and concise manner to support the findings. **(4 Marks)**
- iv. Describe how you would formulate recommendations for preventing similar fraud in the future. What specific control measures would you suggest implementing, and how would you prioritize these recommendations in the report? **(4 Marks)**
- v. Outline the steps you would take to finalize and review the fraud investigation report before submitting it to the Board. What quality control measures would you implement to ensure the accuracy and completeness of the report? Discuss the importance of maintaining objectivity and professionalism in the documentation. **(4 Marks)**