

Demystifying Forensic Accounting

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AGENDA



- Defining and Identifying Fraud
- Audits versus Forensic Investigations
- Investigative Techniques
- International Fraud and Corruption Investigations
- Additional Considerations
- Q&A

DEFINING AND IDENTIFYING FRAUD



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ACCOUNTING FRAUD

- "...*fraud* is an intentional act that results in a material misstatement in financial statements that are the subject of an audit." (SAS 99)
- SAS 99 identifies two major sources of fraud:
 - Misstatements due to fraudulent financial reporting
 - Misstatements due to misappropriation of assets
- SAS 99 does not address corruption

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WHAT IS FRAUD?

- Non-violent crime
- Committed for financial gain
- Utilizes deception, trickery, concealment, dishonesty
- Often referred to as "white collar crime"
- "Fraud" is a legal determination

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INTERNAL AUDIT STANDARDS

- IIA Attribute Standard 1220.A1 states that auditors, when performing internal audits with due professional care, should be aware of the "*probability of significant errors, fraud, or noncompliance*".
- IIA Standard 1210.A2 clarifies the expectation of internal auditors as it relates to fraud:
 - "*Internal auditors must have sufficient knowledge to evaluate the risk of fraud and the manner in which it is managed by the organization, but are not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud.*"

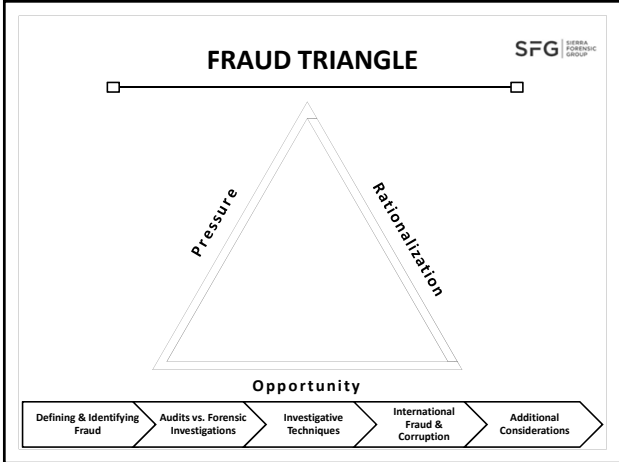
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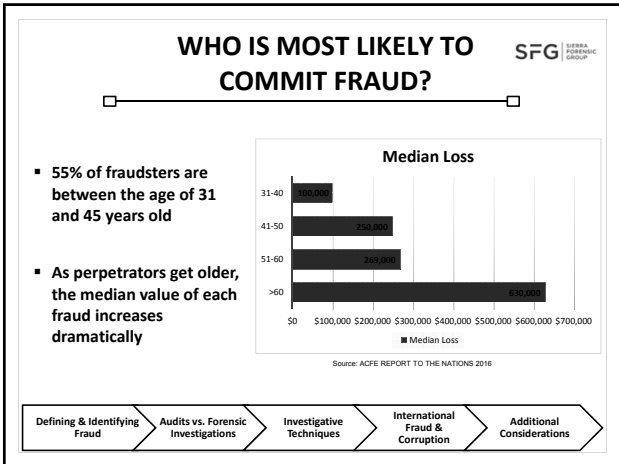
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- ### CHARACTERISTICS OF A WHITE COLLAR CRIMINAL
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- General Profile:**
- Older (30 + years)
 - 69% male, 31% female
 - Post-graduate education
 - Less likely to have criminal record
 - Position of trust
 - Prior accounting experience
 - Detailed knowledge of accounting systems and their weaknesses
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CHRONIC CRIMINAL "PREDATORS"

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Professional criminal

- History of malfeasance
- Looking for the next scam



"Hit and Run" Situations


- Purchasing fraud/kickbacks
- Advance fee scams
- "Ponzi" schemes
- Telemarketing fraud
- Internet fraud
- "Desktop publishing" check fraud
- Stolen credit card numbers
- Fictitious collateral

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FRAUD OR BUSINESS ERROR?

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- Duplicate payments
- Unknown vendor
- Expenses capitalized



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THE MOST COMMON MEANS OF DISCOVERING FRAUD

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Percent of cases detected by tip


- Tip / Hotline
- Accident
- Audit
- Internal Audit
- Compliance review

WITH HOTLINES



47%

WITHOUT HOTLINES



28%

Source: ACFE REPORT TO THE NATIONS 2016

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WHO SHOULD CONDUCT THE INVESTIGATION

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Internal (Internal Audit / HR / Compliance)

- Financially advantageous
- Extensive knowledge of company, internal controls, individuals
- Have to live with the individuals involved after the investigation
- Managers may try to influence the investigation (e.g. "he is an honest and good guy")

External (Investigators / Forensic Accountants)

- No assumptions or preconceived ideas
- Expertise in fraud matters
- Easier to maintain independence
- Law enforcement/authorities more receptive to information from external investigators
- Interviewees may be more open to outsiders

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Often, the LOGICAL thing to... is the WRONG thing to do!

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- ~~First interview the culprit~~
- ~~Confront the culprit~~
- ~~Fire the culprit~~
- ~~Secretly record the subject~~
- ~~Assume the laws are the same state to state or country to country~~

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PERSONAL RED FLAGS

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- Living beyond means
- Dissatisfied or frustrated with job
- Severe personal financial losses
- Addiction problem - drugs/alcohol/gambling
- Change in personal circumstances
- Outside business interests
- Consistently rationalizes poor performance
- Provides unreliable communications and reports
- Very short vacations/rarely takes vacations

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BUSINESS RED FLAGS

- Repeatedly exceeding estimates and budgets
- Transactions that lack documentation or normal approval
- Excessive voids or credits
- Reconciliations not performed
- Poor computer file access/password controls
- Foreign currency transactions
- Cross-border/intercompany transfers
- Management overrides of normal controls
- Significant or unusual changes in customers or suppliers

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LEGAL ISSUES

- Consider legal implications early in the investigation
- Everything can be subpoenaed
- Cannot predict the legal proceedings that could occur after the investigation
- Always consider seeking attorney-client privilege

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WHAT TO KNOW BEFORE YOU START THE INVESTIGATION

- The time frame under review
- Nature of the concerns or allegations
- Location of the site
 - Assess linguistic skills if the site is in a foreign country
 - Determine contact at the location
- Document request list
- The targets
- The reporting requirements, audit committee meetings, and the like pertinent to the investigation

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WHAT TO KNOW BEFORE YOU START THE INVESTIGATION (CONT.)

- Have other investigations of the focus issue been conducted at this location?
- What other entities, regions, or sites may be involved?
- Are background checks of employees conducted before employment?
- Is this an industry or location that has a history or culture of corruption?

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AUDITS V.S. FORENSIC INVESTIGATIONS

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DIFFERENCES

Purpose

Ⓢ Auditors render an opinion on the financial statements as a whole. The significance of transactions, trends, or disclosures is evaluated in the context of the financial statements taken as a whole, and not just a few transactions.

Ⓢ A forensic accounting investigation explicitly does not involve financial statements, but focuses on evaluation of transactions, people, or business units to determine whether there are perceived problems that require further action.

Audience

Ⓢ Audits serve stakeholders and the general public.

Ⓢ Forensic investigations serve those who engaged them (e.g. Board of Directors, Counsel, Sr. Management).

Ⓢ Forensic accountants are still expected to be unbiased and objective about the entity and about the issues being investigated.

Techniques

Ⓢ Auditors focus is on validity, accuracy, and completeness of financial statements.

Ⓢ Forensic accounting investigators are concerned with differentiating between errors and deliberate misrepresentations.

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DIFFERENCES SFG | SERVA FORENSIC GROUP

Execution

- Ⓞ Audits are more consistently executed and documented.
- Ⓞ Forensic investigations are based on a hypothesis or a suspicion.

Participation

- Ⓞ An auditor's work is conducted in the open, known and understood by personnel.
- Ⓞ Company personnel may not know of the forensic investigation, its purpose, or its full scope, depending on the level of secrecy.

Results

- Ⓞ Auditors provide an opinion on financial statements.
- Ⓞ Forensic accountants seek to confirm or deny the existence of a particular problem and to determine its extent and likely cause, which can generate several outcomes.

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GAAS AUDIT VS. FRAUD EXAMINATION SFG | SERVA FORENSIC GROUP

	GAAS Audit	Fraud Examination
Objective	Form an opinion	Determine if fraud is occurring/has occurred and culpable parties
Reason for engagement	Usually required by third party users of FS	Sufficient predication that a fraud has or will occur
Value to management	Credibility to financial information reported by management	Resolve allegations
Sources of Evidence	Accounting data supporting the FS	Review documents financial and non-financial, search public records, and interview
Sufficiency of Evidence	Persuasive rather than convincing	Establish proof to support or refute an allegation

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INVESTIGATIVE TECHNIQUES

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TECHNIQUES

- Data mining
- E-mail & electronic data review
- Search of premises & physical document review
- Background checks
- Interviews and possible interrogation

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DATA MINING


- Quick and easy
- Able to analyze an abundance of data
- Does not replace document reviews, interview, and follow up steps
- Ensure that legal issues are avoided when dealing with international situations

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E-MAIL & ELECTRONIC DATA REVIEW

- Collect electronic data, including e-mails, documents, voicemail, chat transcripts, social media, websites, etc.
- Image data from multiple electronic devices, such as laptops, desktops, cell phones, tablets, etc.
- E-discovery:
 - Maintain chain of custody
 - Preserve integrity of data
 - De-duplicate large volumes of redundant documents
 - Perform strategic keyword searches



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SEARCH OF PREMISES & PHYSICAL DOCUMENT REVIEW

- Perform a search of the office, including:
 - Desk, cubicle, locker
 - Files and documentation
 - Safe, storage areas
- Consider taking photographs and/or video of search (if permitted)

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BACKGROUND CHECKS

<p>Personal</p> <ul style="list-style-type: none"> ▪ Address history ▪ Employment history ▪ Credit history and rating ▪ Assets ▪ Education ▪ Business affiliations ▪ Political affiliations, PEP ▪ Criminal and civil records ▪ Liens/judgments and bankruptcies ▪ Professional licenses ▪ Press/media ▪ Social media 	<p>Business</p> <ul style="list-style-type: none"> ▪ Ownership/shareholders ▪ Board of Directors ▪ Management ▪ Criminal and civil filings ▪ OFAC sanctions ▪ Mergers and acquisitions ▪ Subsidiaries, affiliates, partners ▪ Press/media
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INTERVIEWS

Definition of Interview:

A conversation with a purpose, and that purpose is to gain information

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INTERROGATIONS

Definition of Interrogation:

A confrontational meeting with the objective of obtaining a confession

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The best training for conducting interviews... is to conduct interviews!



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ERRORS MOST COMMONLY MADE BY INTERVIEWERS

- Good rapport not established from onset
- Interviewer interrupts too often
- Interviewer probes for details before determining the witness' complete story-narrative
- Interviewer does not ask enough open-ended questions
- Interviewer does not pause long enough before asking the next question
- Interviewer does not allow the witness enough time to develop a mental image
- Interviewer asks questions not compatible with witness' memory record

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INTERNATIONAL FRAUD AND CORRUPTION INVESTIGATIONS

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FOREIGN CORRUPT PRACTICES ACT ("FCPA")

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- Created in 1977 after over 400 U.S. companies admitted to making questionable or illegal payments to foreign government officials, politicians and political parties.
- Prior to 1998, anti-bribery provisions were only applicable to U.S. persons. Amended in 1998 to apply to foreign firms and persons who facilitate a corrupt payment within the U.S.
- FCPA applies to conduct anywhere in the world and extends to publicly traded companies, including officers, directors, employees, stockholders, and agents (i.e. third party agents, consultants, distributors, joint-venture partners).

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FCPA PROVISIONS

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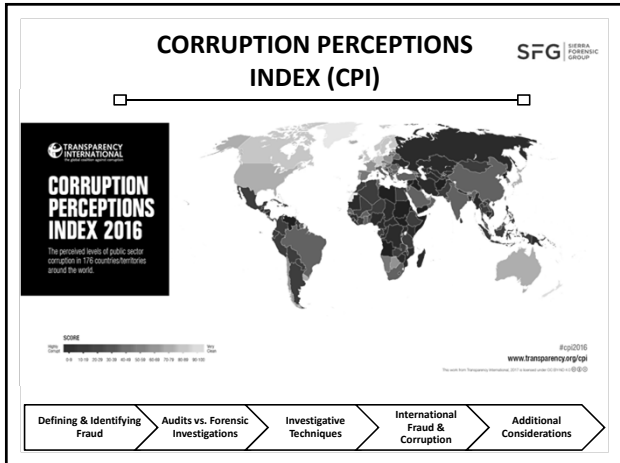
Anti-Bribery Provisions

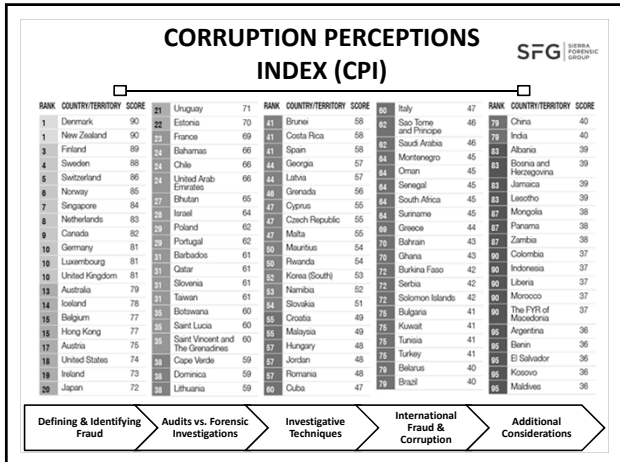
• It is a crime for any US person or company to directly or indirectly pay or promise anything of value to any foreign official to obtain or retain any improper advantage.

Books and Records Provision

• Books and records should accurately reflect transactions and dispositions of assets. Adequate systems of internal controls must be maintained. Failure to implement or intentionally circumventing controls can result in criminal liability

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ADDITIONAL CONSIDERATIONS



CONSIDERATIONS



- Legal issues, such as attorney client privilege and chain of custody
- Whether the matter result in administrative, criminal or civil action
- Post investigation staff response



POSSIBLE LEGAL ACTIONS



Criminal

- Indictment
- Jail
- Arrest
- Beyond a reasonable doubt
- Statutory
- Search Warrant Subpoena



Civil

- Complaint
- \$\$\$
- Service
- A preponderance of the evidence
- Common Law (sometimes statutory)
- Discovery
- Subpoena



UNIQUE RISKS FOR YOUR COMPANY



The Government will pay your employees to snitch on you...

- **Qui Tam lawsuit**
 - 15% and 25% of the proceeds of an action in which the government intervenes (25% to 30% if the government does not intervene)
- **IRS whistleblower**
 - 10% of the money collected
- **SEC**
 - 10-30% of the money collected



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