

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

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- "...*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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Investigations

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Additional
Considerations

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.”***

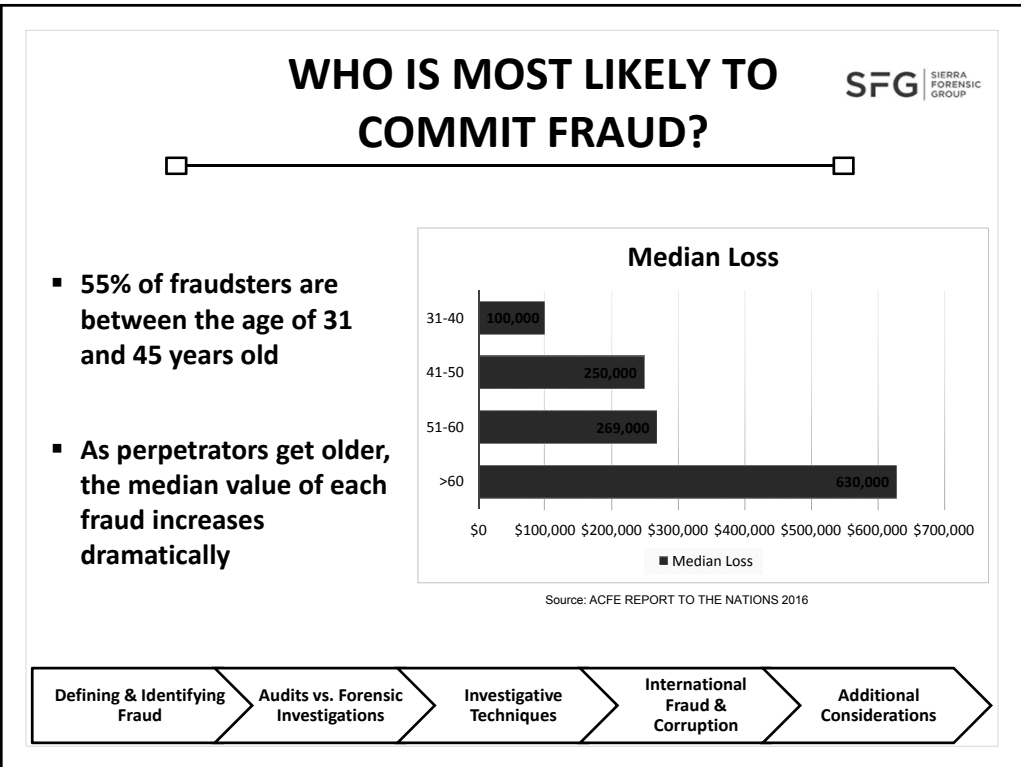
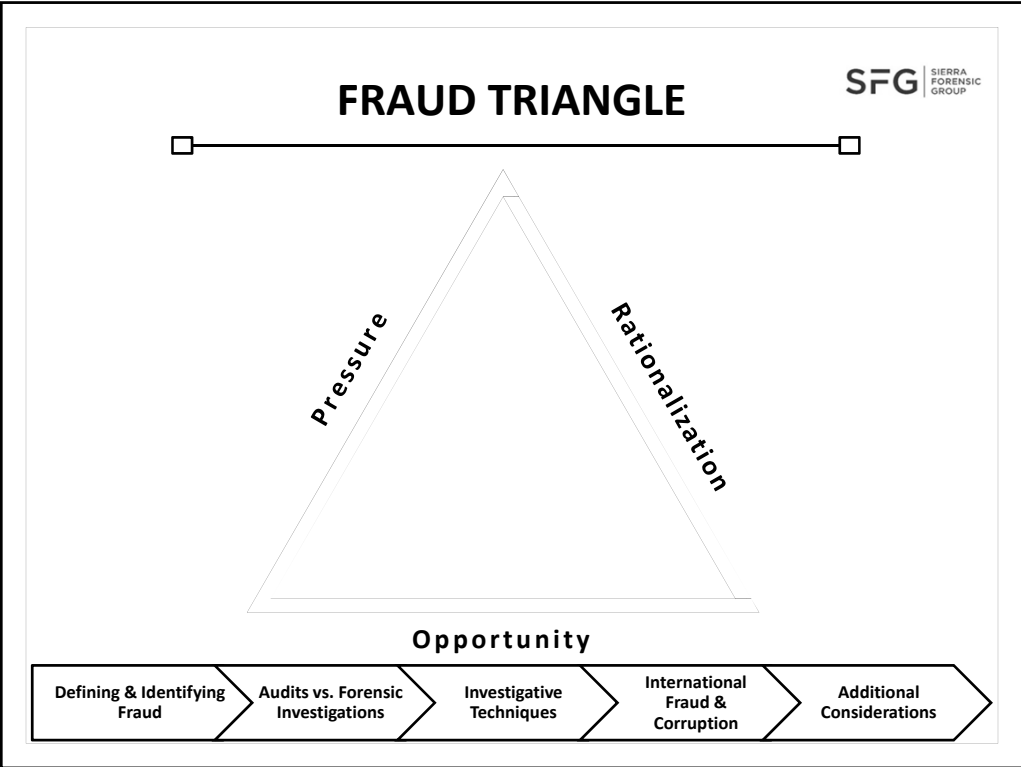
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Investigations

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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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Investigations

Investigative
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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



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

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- 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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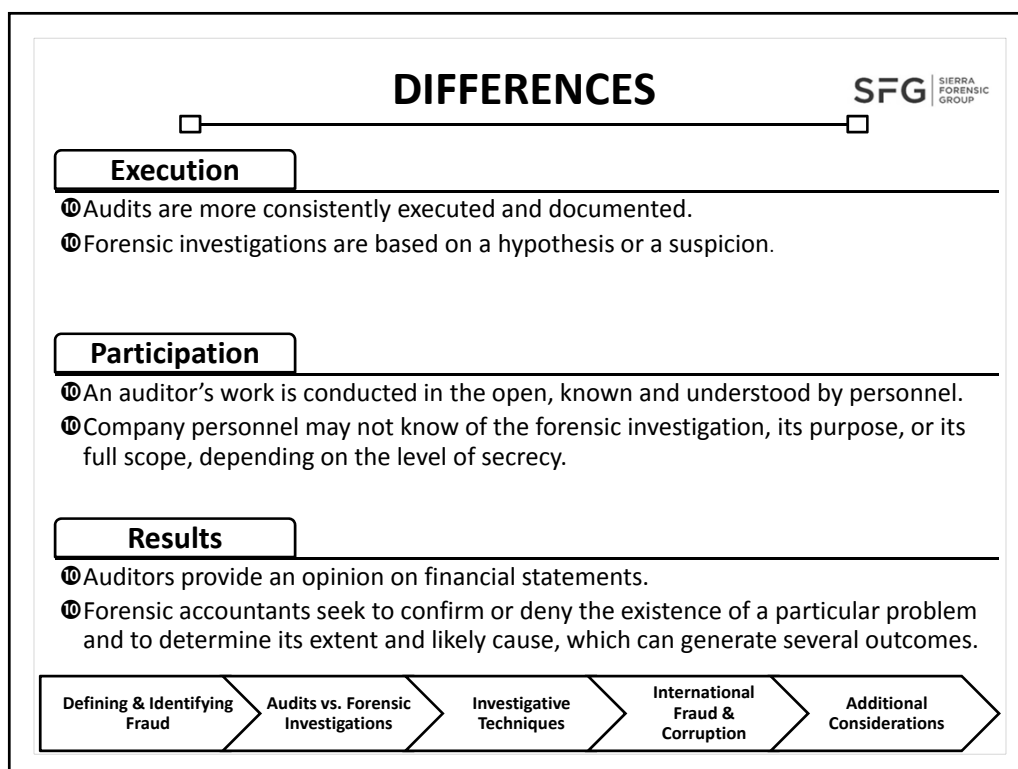
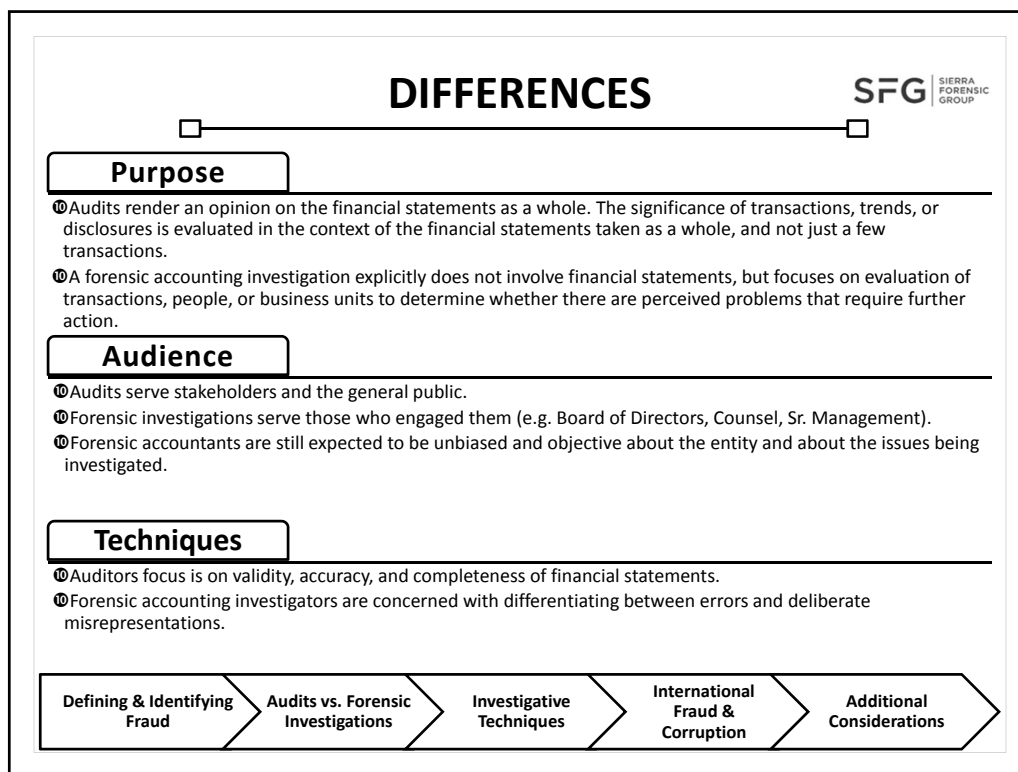
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AUDITS VS. FORENSIC INVESTIGATIONS





GAAS AUDIT VS. FRAUD EXAMINATION

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	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

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- 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

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- 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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Investigations

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BACKGROUND CHECKS

Personal

- 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

Business

- Ownership/shareholders
- Board of Directors
- Management
- Criminal and civil filings
- OFAC sanctions
- Mergers and acquisitions
- Subsidiaries, affiliates, partners
- Press/media



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Investigations

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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

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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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Investigations

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Additional
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INTERNATIONAL FRAUD AND CORRUPTION INVESTIGATIONS



FOREIGN CORRUPT PRACTICES ACT (“FCPA”)



- 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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Investigations

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Techniques

International
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Additional
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FCPA PROVISIONS



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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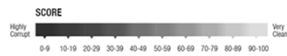
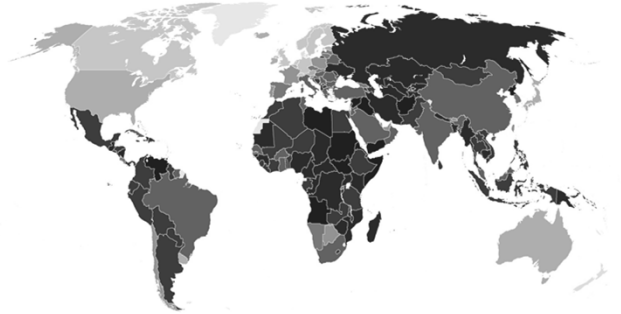
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Additional
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CORRUPTION PERCEPTIONS INDEX (CPI)

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Audits vs. Forensic
Investigations

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Techniques

International
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Additional
Considerations

CORRUPTION PERCEPTIONS INDEX (CPI)

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RANK	COUNTRY/TERRITORY	SCORE	RANK	COUNTRY/TERRITORY	SCORE	RANK	COUNTRY/TERRITORY	SCORE	RANK	COUNTRY/TERRITORY	SCORE
1	Denmark	90	21	Uruguay	71	60	Italy	47	79	China	40
1	New Zealand	90	22	Estonia	70	61	Sao Tome and Principe	46	79	India	40
3	Finland	89	23	France	69	62	Saudi Arabia	46	83	Albania	39
4	Sweden	88	24	Bahamas	66	64	Montenegro	45	83	Bosnia and Herzegovina	39
5	Switzerland	86	24	Chile	66	64	Oman	45	83	Jamaica	39
6	Norway	85	24	United Arab Emirates	66	64	Senegal	45	83	Lesotho	39
7	Singapore	84	27	Bhutan	65	64	South Africa	45	87	Mongolia	38
8	Netherlands	83	28	Israel	64	64	Suriname	45	87	Panama	38
9	Canada	82	28	Poland	62	69	Greece	44	87	Zambia	38
10	Germany	81	29	Portugal	62	70	Bahrain	43	90	Colombia	37
10	Luxembourg	81	31	Barbados	61	72	Ghana	43	90	Indonesia	37
10	United Kingdom	81	31	Qatar	61	72	Burkina Faso	42	90	Liberia	37
13	Australia	79	31	Slovenia	61	72	Serbia	42	90	Morocco	37
14	Iceland	78	31	Taiwan	61	72	Solomon Islands	42	90	The FYR of Macedonia	37
15	Belgium	77	35	Botswana	60	75	Bulgaria	41	95	Argentina	36
15	Hong Kong	77	35	Saint Lucia	60	75	Kuwait	41	95	Benin	36
17	Austria	75	35	Saint Vincent and The Grenadines	60	75	Tunisia	41	95	El Salvador	36
18	United States	74	38	Cape Verde	59	75	Turkey	41	95	Kosovo	36
19	Ireland	73	38	Dominica	59	79	Belarus	40	95	Maldives	36
20	Japan	72	38	Lithuania	59	79	Brazil	40			
			41	Brunei	58						
			41	Costa Rica	58						
			41	Spain	58						
			44	Georgia	57						
			44	Latvia	57						
			48	Grenada	56						
			47	Cyprus	55						
			47	Czech Republic	55						
			47	Malta	55						
			50	Mauritius	54						
			50	Rwanda	54						
			52	Korea (South)	53						
			53	Namibia	52						
			54	Slovakia	51						
			55	Croatia	49						
			55	Malaysia	49						
			57	Hungary	48						
			57	Jordan	48						
			57	Romania	48						
			60	Cuba	47						

Defining & Identifying
Fraud

Audits vs. Forensic
Investigations

Investigative
Techniques

International
Fraud &
Corruption

Additional
Considerations

CORRUPTION PERCEPTIONS INDEX (CPI)

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95	Sri Lanka	36	RANK	COUNTRY/TERRITORY	SCORE	138	Myanmar	28	RANK	COUNTRY/TERRITORY	SCORE
101	Gabon	35	120	Dominican Republic	31	138	Nigeria	28	159	Burundi	20
101	Niger	35	120	Ecuador	31	138	Papua New Guinea	28	159	Central African Republic	20
101	Peru	35	120	Malawi	31	142	Guinea	27	159	Chad	20
101	Philippines	35	123	Azerbaijan	30	142	Mauritania	27	159	Haiti	20
101	Thailand	35	123	Djibouti	30	142	Mozambique	27	159	Republic of Congo	20
101	Timor-Leste	35	123	Honduras	30	145	Bangladesh	26	164	Angola	18
101	Trinidad and Tobago	35	123	Laos	30	145	Cameroon	26	164	Eritrea	18
108	Algeria	34	123	Mexico	30	145	Gambia	26	166	Iraq	17
108	Côte d'Ivoire	34	123	Moldova	30	145	Kenya	26	166	Venezuela	17
108	Egypt	34	123	Paraguay	30	145	Madagascar	26	168	Guinea-Bissau	16
108	Ethiopia	34	123	Sierra Leone	30	145	Nicaragua	26	169	Afghanistan	15
108	Guyana	34	131	Iran	29	151	Tajikistan	25	170	Libya	14
113	Armenia	33	131	Kazakhstan	29	151	Uganda	25	170	Sudan	14
113	Bolivia	33	131	Nepal	29	153	Comoros	24	170	Yemen	14
113	Vietnam	33	131	Russia	29	154	Turkmenistan	22	173	Syria	13
116	Mali	32	131	Ukraine	29	154	Zimbabwe	22	174	Korea (North)	12
116	Pakistan	32	136	Guatemala	28	156	Cambodia	21	175	South Sudan	11
116	Tanzania	32	136	Kyrgyzstan	28	156	Democratic Republic of Congo	21	176	Somalia	10
116	Togo	32	136	Lebanon	28	156	Uzbekistan	21			

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Fraud

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Investigations

Investigative
Techniques

International
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Additional
Considerations

ADDITIONAL CONSIDERATIONS

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CONSIDERATIONS

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- 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

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POSSIBLE LEGAL ACTIONS

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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

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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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Audits vs. Forensic
Investigations

Investigative
Techniques

International
Fraud &
Corruption

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