

# Auditors' Fraud Primer

CAST Presentation

Dallas Chapter IIA/Dallas Chapter ACFE Joint Meeting • November 1, 2011

Cityplace Conference Center • Dallas, Texas

Ray Lindsay, CPA/CFF CFE



# Overview

- Fraud and Occupational Fraud
- Explaining Fraud
- Fraud Costs
- Fraud Discovery
- Common Occupational Frauds
- Addressing or Investigating Frauds



# Fraud and Occupational Fraud

There are a lot of definitions of the term “fraud”.

Everyone knows what it means, but sometimes it is hard to capture meaningfully.



# Fraud and Occupational Fraud

“Deceit, trickery, sharp practice, or breach of confidence perpetrated for profit or to gain some unfair or dishonest advantage.” - *Dictionary.com*

More specifically, we are focused on occupational fraud.



# Fraud and Occupational Fraud

Occupational fraud is “the use of one’s occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization’s resources or assets.”

*– ACFE 2010 Report to the Nations on Occupational Fraud and Abuse*



# Fraud and Occupational Fraud

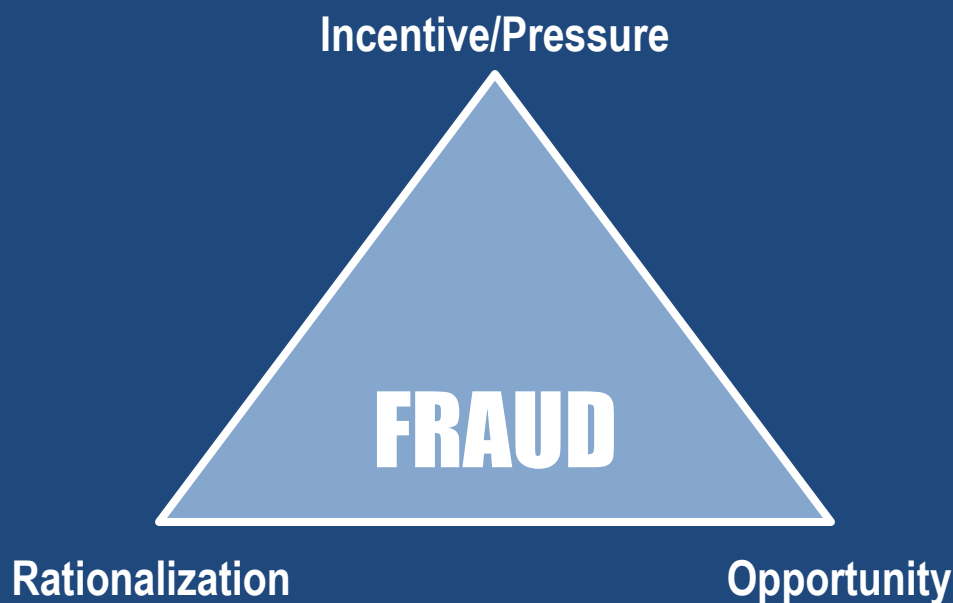
Occupational fraud may affect:

- The employer
- Other employees
- Customers
- Vendors
- Investors
- Creditors
- Regulators
- The Community



# Explaining Fraud

Sociologist Donald Cressey formed one of the cornerstones of modern fraud study when he established the “Fraud Triangle”.



# Fraud Costs

From the *ACFE's 2010 Report to the Nations on Occupational Fraud and Abuse (Report to the Nations)*:

- Typical organization loses 5% of its annual revenue to fraud. Worldwide, this figure translates to potential total fraud loss exceeding \$2.9 trillion annually.
- The median loss in the study was \$160,000. Almost 25% of the frauds exceeded \$1 million.
- The frauds lasted a median of 18 months before being detected.



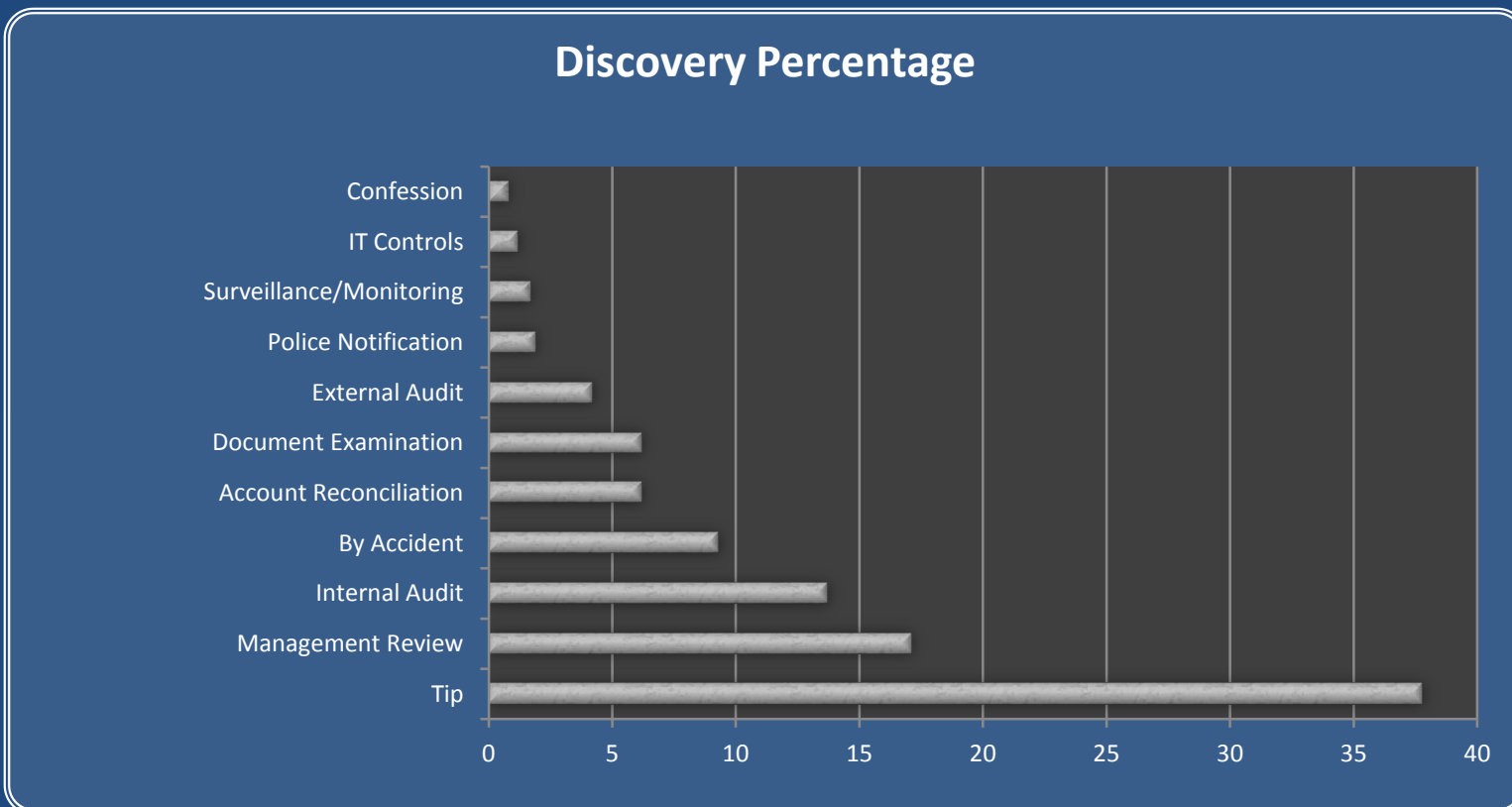
# Common Occupational Frauds

Three main types of occupational fraud:

- Asset misappropriation
  - Higher frequency, lower average value
- Corruption schemes
- Fraudulent statements
  - Lower frequency, higher value



# How Fraud is Found



More than 75% of all U.S. fraud discovery can be traced to four factors: accidental discovery (9.3%), internal audit (13.7%), and management review (17.1%), but tips were by far the largest factor at 37.8%. - *Report to the Nations*

# Addressing Fraud

Fraud plan –

Have an action plan in place so when a fraud is discovered, the organization does not squander time, resources, and investigative opportunities.



# Fraud Plan

The fraud contingency plan could define:

- Roles and responsibilities
- Resources available
- Authority for investigation/action
- Anticipated or desired outcomes



# Fraud Plan

The fraud contingency plan is a “canned” project plan. It provides structure in the initial stages of the investigation and can help keep the project on track through the course of the investigation.

It can help protect the integrity of the investigation, meaning the difference between a successful or a failed outcome.



# First steps

Your fraud plan should help assign responsibility for investigation activities. In many cases, internal audit is one of the primary groups participating in the investigation.

Internal audit may fill a lead role, a supporting role, or both.



# First steps

Short list of first responders may likely include:

- Internal Audit
- Legal Counsel
- Human Resources
- Senior Management

Decide on an initial course of action and outline responsibilities.



# First steps

## Attorney/client privilege

Is your investigation covered by attorney/client privilege?

No – unless you are an attorney or senior management and legal counsel have determined that the investigation should be conducted by legal counsel. You would then work under the direction of, and report to, legal counsel. If asked to work under direction of legal counsel, it is best to have that request documented.



# Preliminary Investigation

Gather as much relevant information as you can.

Identify investigative resources that may be available:

- Accounting and business records
  - Determine how those records are maintained and what may be required for you to get access
- Internal control and process documentation
- Public records or information in the public domain
  - Do not overlook the internet; Social media can be a valuable resource



# Preliminary Investigation

Gather as much relevant information as you can.

Identify investigative resources that may be available:

- Personnel that may be able to provide background to assist you in focusing the investigation (not necessarily witnesses)
- Potential witnesses
- Outside resources or consultants
  - Consider finances/budget for outside resources



# Executing the Investigation

## Staffing:

- Identify and brief internal staff resources on their assignments
- Identify and engage any needed outside resources

## Coordination:

- You will need resources from various personnel through the course of the investigation. You will have to work discreetly with management to facilitate those efforts.



# Executing the investigation – Documents and records

Examine relevant documents and records.

- Determine what records you will need and how you can access them
- Consider automated tools (CAATs or other specialized investigative tools)
- Make sure you understand the value to be gained, and the cost of examining, certain records (email, IM, texts, phone records)



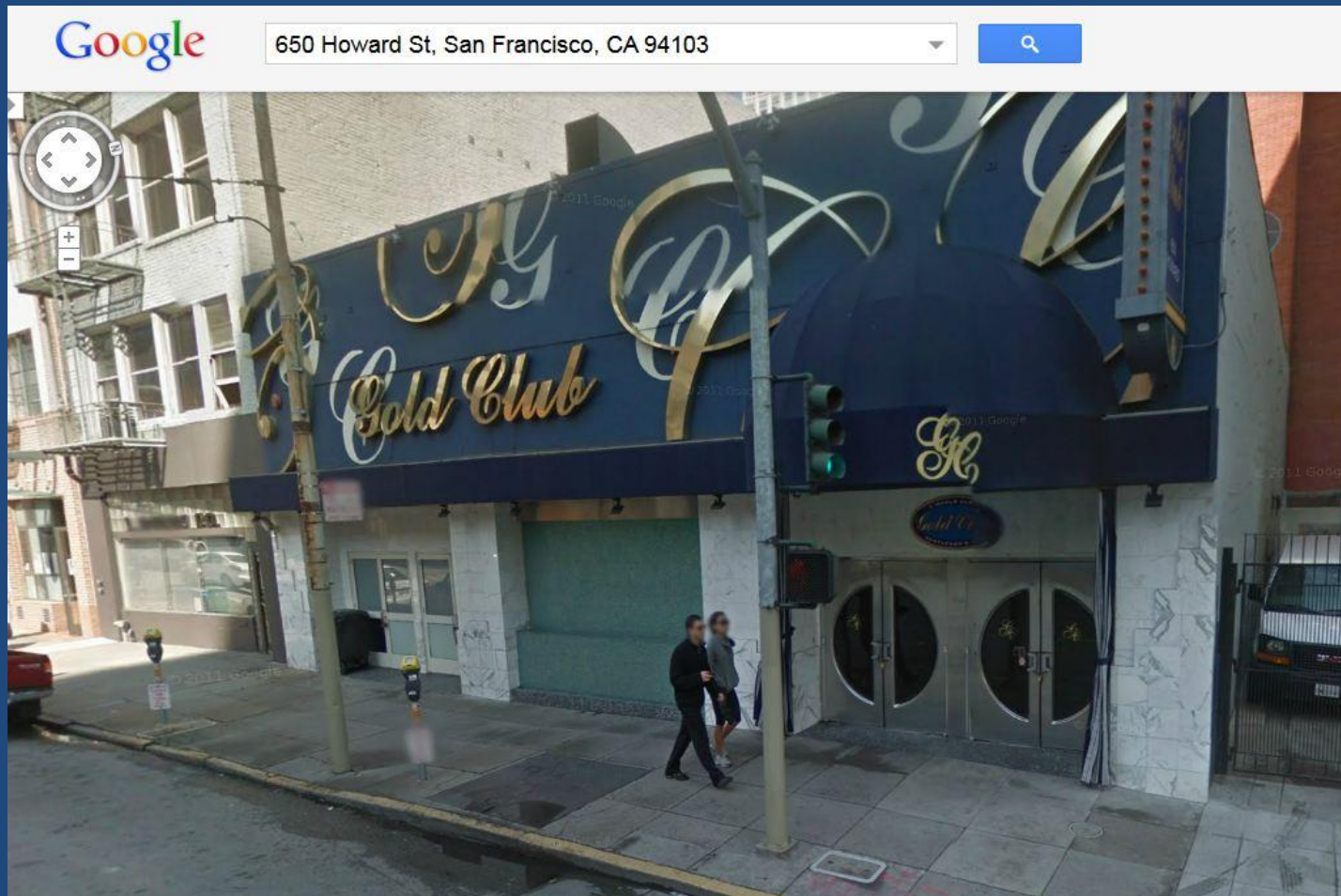
# Executing the investigation – Internet Example

## Using the internet:

- In reviewing Corporate Visa card activity, the team noted several unusual high dollar transactions (>\$3,500) at merchants that lacked any useful detail in their Visa merchant profile. These had names similar to “SC Enterprises” or “GC Corp.” and merchant category code indicating restaurants or meeting facilities. One thing the team was able to get from Visa’s merchant profile was an address. They plugged the address in to Google Maps and then went to street view. They saw:



# Executing the investigation – Internet Example



# Executing the investigation – Internet Example



The image shows a Google search interface. The search bar contains the text "gold club, san francisco, ca 650 howard street". Below the search bar, the word "Search" is displayed in red, followed by the text "About 191,000 results (0.14 seconds)". On the left side, there is a vertical menu with options: "Everything" (selected), "Images", "Maps", "Videos", "News", and "Shopping". The main search result is for "Gold Club San Francisco - World Class Gentlemen's Club ...". The URL is "www.goldclubsf.com/". The description reads: "Gold Club San Francisco. WORLD CLASS GENTLEMEN'S CLUB & RESTAURANT 650 Howard St • San Francisco, CA 94105 • (415)-536-0300. Submit your ...". Below the description, there is a red location pin icon followed by the address "650 Howard St San Francisco, CA 94105" and the phone number "(415) 536-0300". To the right of the address, the hours are listed: "Hours: Sun, Sat 7pm–2am; Mon-Fri 11:30–2am" and "Transit: Metro Montgomery Station/Downtown". Below the hours, there is a link for "Directions - Is this accurate?". At the bottom of the result, there are four yellow stars and a grey star, followed by the text "13 Google reviews - Write a review" and "insiderpages.com (10) - yahoo.com (4) - citysearch.com (11)".

# Executing the Investigation – Interviews

Interviews can be informational, admission seeking, or both.

The format of interviews varies in each investigation, but there are a few things that you may wish to consider.



# Executing the Investigation – Interviews

Determine who will participate and how you will conduct an interview. I prefer to have two interview team members: one is primarily responsible for guiding the interview; the second is primarily responsible for documenting the interview – taking detailed notes and recording observations.



# Executing the Investigation – Interviews

Determine where you will conduct the interview.

Some points to consider:

- Select a neutral location. It may be helpful to find a remote interview room.
  - Subjects may be more open if they are not observed by coworkers talking with an auditor or investigator
- Leave the interview subject an open pathway to the door. Consider offering them a chair closest to the exit.
- Do not lock the door.



# Executing the Investigation – Evidential Items

If you gather hard evidence, you will need to secure it and document a chain of custody. Being able to show who handled evidence and what they did to it may be critical to introducing it in a trial.

If possible, make copies and work from them, preserving the original evidence.



# Executing the Investigation – Synthesis and Analysis

Throughout the course of your investigation, synthesize and critically analyze what you are learning through examination of evidence and interviews.

Think outside the box. In many cases, you will end up some place entirely different than where you expected when you started.



# Executing the Investigation – Synthesis and Analysis

Do question where your suspicion is guiding you.

Always make sure you are basing your results on the evidence.

At the end of the investigation, it will not be what you believe to be the truth, but what the evidence shows.



# Executing the Investigation – Reporting Findings

Be mindful of what you say during the course of your investigation and at the conclusion. Do not put yourself or your employer in the position of committing slander or libel.

The ACFE Code of Conduct specifically states that “no opinions shall be expressed regarding the legal guilt or innocence of any person or party.”



# Conclusion

Questions or comments

