



## Tips For An Efficient And Effective Fraud Investigation

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Internal fraud can be defined as “the use of one’s occupation for personal enrichment through the deliberate misuse or misapplication of the organization’s resources or assets.”[1] By definition, this common and serious issue appears to be relatively straightforward. Yet, as forensic accountants, we recognize that conducting an internal fraud investigation can be a complex process. The intricacies of each case stem mainly from the fact that no fraud is the same; therefore, there is no “one size fits all” work plan. Despite the many differences between each case, every internal fraud investigation is supported by a detailed analysis of the documentation produced.

Therefore, the more complete the document production is, the more comprehensive the analysis will be.

In virtually all forensic accounting investigations involving allegations of concerns of fraud, there is a predication or some identifiable concern that can help narrow the focus of the investigation. In its broadest sense, a fraud could involve a diversion of assets already received and reflected in the accounting records of the business (most often cash or something that is convertible to cash). These types of fraud schemes are referred to as “on-book” frauds in that the evidence of the fraud may be found in the accounting records. A classic example of this is a payables clerk inappropriately directing a payment from the corporate account to their personal benefit.

Conversely, some fraud schemes involve the diversion of funds or assets prior to the company’s receipt of the funds. A simple example of this is an accounts receivable clerk misdirecting funds to their personal benefit as the funds are coming into the business (but prior to their entry into the accounting records). These are referred to as “off-book” fraud schemes. On many occasions, the fraud perpetrator may operate both types of schemes simultaneously.

Although the types of documents will vary on a case-by-case basis, there are some general factors that forensic experts consider when embarking on a fraud analysis. These considerations,



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as outlined below, will facilitate your preparation of a complete document request, which will ultimately lead to an efficient and effective fraud investigation.

### **Consider the Background of the Alleged Fraud Perpetrators and Purported Victims**

As appropriate, it is important to gain control over the paper records and computers utilized by those under investigation. Within these networks, you will be exposed to a multitude of documents that may provide insight into potential fraud motives and evidence of fraudulent transactions. For instance, emails can provide pertinent insight behind fraud schemes, raise awareness about other individuals that may be involved in fraudulent activity and indicate the timing of events. Likewise, internally prepared memos can provide parallel information.

In terms of paper files, the forensic expert will maintain a healthy skepticism while analyzing these as they may contain fraudulent information. The forensic expert needs to keep in mind that just because something is written on a piece of paper doesn't mean that it is real. However, similar to electronic records, they are very useful in understanding the fraudulent activity and those who may be involved. In addition, paper records can be especially effective when comparing and contrasting with the electronic files. For example, if a paper document has referenced a certain date, yet the electronic file references a much different date, the issue of backdating can be an insinuation of fraud.

Retrieving personnel files can also be useful sources of information when trying to learn more about the individuals involved. These records can provide information about job descriptions and any issues that arose during a suspect's tenure at the organization. Past actions exhibited by the perpetrators can be indicative of current behavior. Particular care, however, should be taken when accessing and reviewing personnel files to ensure that you do not violate employment or privacy laws.

Additionally, performing public records searches, when possible and permissible, can provide valuable data. These records, which can typically be searched for by the forensic expert, may divulge information about any undisclosed relationships. Furthermore, public records may provide evidence of financial distress or newfound wealth, both of which can be important factors in a fraud investigation.

The discovery of an undisclosed relationship, such as ownership interests in a vendor of the



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business, may help to narrow the focus of your investigation. Evidence of financial distress (i.e. bankruptcy filing, tax liens, etc.) may cause an otherwise loyal employee to commit fraud. Evidence of newfound wealth (i.e. a second home, luxury car or suggestions of a lifestyle inconsistent with the known levels of income) may represent the benefits of embezzled funds.

Lastly, utilizing and relying upon analyses performed by others can be a worthwhile supplement to a fraud analysis. The forensic expert will need to assess its reliability by testing the data. Based upon the results of their testing, the forensic expert can decide whether or not it would be beneficial to use the work product to support the analysis.

### **Consider the Policies and Procedures of the Financial Operations**

Assuming for purposes of this article that the fraud concern relates to possible embezzlement by a member of the company's accounting department, it is important to understand how the various accounting functions are supposed to operate. This knowledge should then be contrasted with a gained knowledge of what actually happens. To understand the accounting processes of the business, it is important to obtain documents that provide information regarding the policies and procedures governing its financial operations. This data can be outlined in handbooks, policies and procedures manuals, and through conducting interviews with relevant staff members. Interviews with accounting staff should include a discussion about what is supposed to happen as compared with what actually happens. The details regarding how financial operations are supposed to be conducted is a valuable control to reference, while looking further into the financial data. Being aware of the company's accepted financial processes, can allow the forensic expert to detect transactions that deviate from the accepted protocol.

Requesting all of the organization's internal and audited financial statements, when available, is also beneficial to a fraud analysis. Analyzing these annual and/or quarterly statements, will provide a general overview of the financial health of the organization. Analyzing select financial statement data, such as a particular expense item, over multiple periods, may reveal unusual fluctuations or inconsistencies, which might require further analysis. This is referred to as a "horizontal analysis."

Additionally, if audited financial statements are available, the notes to the financial statements may illustrate details about the organization that may have been previously unknown. For instance, the notes may disclose related parties transactions or financial interests that may have



been previously unknown. Identifying these issues will allow the forensic expert to analyze supporting financial records with a greater awareness.

In order to examine the accounting records and supporting documentation, it is critical to determine how these records were maintained by the business. Once you have made this determination, efforts should be made to obtain the relevant financial records including electronic files. For example, if the business utilizes QuickBooks accounting software, requesting the native QuickBooks files is an extremely useful analytical tool. Having access to the native files enables the forensic expert to analyze individual transactions, view detailed descriptions for each accounting entry, and identify the various customers and vendors.

The forensic expert can use the accounting software to run a number of financial summary reports using a variety of criteria. Additionally, these detailed records allow the forensic expert to delve into the finances of the organization by examining them in a multitude of formats. For instance, QuickBooks offers a variety of analytical features, which include running financial report summaries for specific date ranges and exporting them into Excel. Once the desired data is extracted, being able to organize it in various presentations can highlight fraudulent patterns. Recognizing and understanding these patterns allows the forensic expert to understand the substance of the transactions over the form of the transactions.

It is important to obtain a level of comfort about the accuracy and integrity of the accounting records, principally the general ledger, before these records can be completely relied upon for purposes of the forensic accounting analysis. The banking records, ideally obtained directly from the banking institution, can be used to determine whether transactions are being accurately recorded into the accounting system.

### **Consider Potential Areas the Funds Could Have Been Diverted**

Requesting banking records of the business entity and alleged fraud perpetrator, if available, can assist the expert in verifying the fraud and identifying further evidence to support the fraud. An analysis of banking records may reveal, among other things, the final destination of the diverted funds. If the investigation requires the tracing of monies to quantify damages, the availability of bank statements, canceled checks and deposit slips are key.

As discussed in the section above, reconciling the business's accounting records can expose



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fraud in the event they are incongruent with the actual banking records. For example, the date, amount and payee details on canceled checks should coincide with what has been entered into the accounting records. Many fraud schemes are uncovered by the discovery that a check was actually issued to someone other than what was entered in the accounting records. Furthermore, analyzing canceled check copies of the business can reveal additional information about where funds were deposited. Specifically, details on the back of a check copy can reveal who endorsed the check and what bank account it was deposited into. In some cases, the individual who endorsed the check and the account it was deposited into may be different from the payee identified on the front of the check. This can be especially prevalent if the suspect has signing authority over the business account.

Once the fraud scheme is identified, performing a line-by-line analysis of the general ledger (or specific accounting entries, depending on how large the general ledger is) and reconciling the information to the suspect's bank accounts can reveal disguised transactions. For example, the general ledger may indicate a wire transfer was paid to a third-party vendor, yet a transfer for the same amount on the same date was deposited into the suspect's bank account. In addition to analyzing the bank statements of the suspect, analyzing credit card statements can reveal other modes of fund diversion. Instead of company funds being directly paid to the suspect, they can indirectly benefit the individual by relieving debt.

As previously stated, not all of the aforementioned document types will be available or relevant to every internal fraud investigation. However, if any of these considerations apply to an investigation, it is advantageous to request the related documents at the inception of the case. The more your forensic expert has to work with as they launch their analysis, the more efficient and effective their analysis will be.

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[1] <http://www.acfe.com/fraud-101.aspx>

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