
FINANCIAL INVESTIGATIONS: AN OVERVIEW OF THE PROCESS

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WHAT IS THE LEGAL DEFINITION OF FRAUD?

An intentional act or statement designed to deprive another of money or property by deceit or deception

Other unethical conduct, not amounting to legal fraud, may also be detrimental and costly to the company.

WHAT ARE THE PRINCIPAL TYPES OF FRAUD?

Embezzlement

Willfully and knowingly

Stealing or converting

Any thing of value

Which was lawfully entrusted to the

Defendant

Examples:

Theft of cash and property

Unauthorized use of property

"Lapping" schemes

Check for cash substitution schemes

Fictitious vendors

False Statements and Claims

Willfully and knowingly

Making a false statement or claim

About a material point

In a matter in which there is

A duty to report honestly

Examples:

Inflated travel and expense claims

False labor charges

Failure to meet contract specs

Product substitution

**Inflated costs in cost reimbursable
contracts**

Kickbacks (Commercial Bribery)

Giving or receiving

A thing of value

With the intent to corruptly influence

A business decision

Without the Employer's Consent

Examples: Things of value:

Gifts

Travel

Lavish entertainment

Prostitutes

Leased automobiles

"Loans"

Cash

"Consulting fees"

Examples: Corrupt Influence:

Rig selection process

Approve higher prices

Make unnecessary purchases

Approve bogus change orders

Accept low quality

Conflict of Interest

An agent or employee

**Taking an interest in a transaction
which is potentially adverse to the
principal without full disclosure and
consent**

Examples:

**Accept kickbacks or favors from
suppliers**

Ownership in a supplier

Job offer from supplier

Supplier employs spouse (or offers to)

HOW TO PROVE FRAUD OR UNETHICAL CONDUCT

**In all cases of suspected fraud,
the auditor should collect and
meticulously analyze the available
facts, including intent**

HOW TO PROVE INTENT

- 1. Inference from all the facts**
- 2. Alteration or destruction of documents**
- 3. "False exculpatories"**
- 4. Pattern of behavior**
- 5. Testimony of Co-conspirator (plus Corroboration)**
- 6. Confession**

HOW IS FRAUD DETECTED?

Tips, protests and complaints

Accident

Audits

Computer searches

WHAT ARE THE GENERAL INDICATORS OF FRAUD?

High risk environment (weak controls, etc)

Questionable, inadequate documentation

Records don't balance

Explanations don't make sense

Too many, too few; too high, too low...

Indicators of Embezzlements

Cash Receipts Schemes

Missing documents

Shortages or Overages

Customer Complaints

Excessive Voids or Refunds

High number of adjusting entries

Living beyond means

Financial problems

No time off

Cash Disbursements Schemes

Fictitious Vendor

Unprofessional appearing invoices

Vendor not on lists

No business filings

Not in D&B

Incomplete address & P.O. Box
Same address or telephone # as employee
No purchase order, receiving record or inventory
Sequentially numbered invoices
Round number invoice amounts (when unusual)
Second endorsement on check

Indicators of False Statements & Claims

Travel & Expense Vouchers

Inadequate supporting documents
Apparently altered or copied receipts
Sequential or out of order receipts
Expenses exactly equal advance
Multiple employees claim same expense
Inconsistent claims (e.g., taxi and parking)

False Labor Cost Reports

Unreasonable overtime claims
Altered time cards
Same employee simultaneously billed to two jobs
Labor costs shifted from fixed-price to cost plus contracts

False, Inflated & Duplicate Invoices

Discrepancies between invoices and

PO's , receiving docs and inventory

Inadequate or suspect supporting

documentation

Items missing from inventory

Payments in duplicate amounts

Failure to Meet Contract Specs

Failures & complaints from users

Failed tests & inspections

Contractor conducts tests

Inadequate documentation

Product Substitution (and Counterfeit parts)

Odd or generic packaging

High rate of failures or returns

No compliance certificate

Supplier conducts tests

Indicators of Kickbacks

Favorable treatment of certain suppliers

Improper, repeated selection

High prices

High volume purchases

Low quality

Late delivery

Continued use after problems

Living beyond means by employee

Undisclosed outside business by employee

Involvement of unnecessary middleman

Indicators of Conflicts of Interest

Favorable treatment of particular vendor

Undisclosed outside business

Employment discussions with suppliers

Employee and supplier addresses

or telephone number match

**WHAT SHOULD AN AUDITOR DO WHEN
POSSIBLE FRAUD IS DETECTED?**

**If an auditor encounters an allegation
or indication of possible fraud, he or she
should:**

- 1. Document the discovery**
- 2. Fully debrief the person making
the allegation or suggestion**
- 3. Using his or her knowledge of fraud,
the auditor should:**
 - a. Identify other indicators of the
possible fraud**
 - b. Identify all potentially suspect parties,
transactions
and time frames**
 - c. Determine possible legitimate
explanations**
 - d. Ask sensible "audit type" questions of
informed
parties (it is permissible to
question even suspect persons - be
sure to carefully record their
answers)**

- e. Obtain and record all relevant documentation (originals are usually not necessary at this stage) and memos of interviews**
- f. If serious fraud is indicated, request necessary assistance (per IIA audit standards)**

HOW NOT TO "BLOW THE CASE"

Most auditors worry unnecessarily about making a mistake that will prejudice an investigation. Using common sense, following normal audit methodology at the outset, and obtaining appropriate assistance later will protect the auditor from serious error.

Specifically, the auditor should avoid:

- 1. Making any accusations of guilt**
- 2. Expressing any opinions of guilt**
- 3. Saying or doing anything that could be viewed as discriminatory**
- 4. Making sloppy errors in work papers**

5. **Acting beyond the scope of his or her experience or skills, e.g. attempting to obtain a confession from a person maintaining his or her innocence**

Even these missteps will usually not ruin a case, but may make the proof more difficult and subject the company to disruptive counterclaims and side issues.

FRAUD CASE STUDIES

1. **What was the motivation for the fraud?**
2. **What were the indicators?**
3. **How could the perpetrators have avoided or delayed detection?**
4. **What steps should the company have taken when the fraud was discovered?**
5. **How can similar schemes be deterred or prevented?**

WHY DO WE OFTEN FAIL TO DETECT FRAUD (UNTIL TOO LATE)?

- 1. Don't understand fraud**
- 2. Lack of "professional skepticism"**
- 3. Failure to examine source documents**
- 4. Failure to do independent checks**
(Don't just ask the possible bad guy for an explanation)
- 5. Don't pursue discrepancies because "not material"**
- 6. Not enough time**
- 7. Don't want to**

HOW CAN WE BETTER DETECT FRAUD?

Encourage, facilitate tips and complaints

Use and monitor "Hotlines"

Review vendor letters

Review internal questionnaires

Make a successful case or two

Increased fraud awareness during audits

More "professional skepticism"

**Better knowledge of fraud schemes
and indicators**

More effective interviewing in audits

What to ask

How to ask

Better pre-employment screening

Better vendor qualification

Publicize the Business Conduct Policy

Continue to acquire in-depth fraud expertise

THE HUMAN ELEMENT

COURSE NOTES

Since this course deals with the results of human behavior, we present in this section several quotations which attempt to deal with the question: Why do honest people steal? Fraudulent behavior on the part of both management and employees is briefly examined. The sources of the quotations are listed at the end of these notes.

"No matter what the degree of restriction imposed on trusted persons (including managers) in modern business, it is still true that an element of trust must remain. Even in this day of computer accounting and computer auditing, auditors and other accountants must necessarily give managers and employees enough freedom to do business, which means giving them enough freedom to commit management frauds as well as embezzlements".¹

MANAGEMENT FRAUD

A greater degree of trust has to be reposed in executives and managers than in employees, simply because of their greater responsibilities and hence, opportunities. The following excerpt is from an article entitled **Executive Dishonesty: Misuse of Authority for Personal Gain.**

"When I looked for a dictionary definition of executive dishonesty, I was not surprised to find there was none. I've come up with my own definition of executive dishonesty as "the misuse of authority for personal gain, to the detriment of an organization." This definition does not limit the subject to presidents, vice presidents and chairman of the board; it encompasses anyone who exercises authority over others in making decisions that could adversely affect the company.

This could include a chairman of the board or president who becomes involved in the manipulation of stocks for personal gain; it could include a vice president of personnel who hires an unqualified relative or friend; it could include a purchasing agent who accepts an inferior product at a higher price to receive a kickback; or it could include a shipping foreman who orders an employee to overload a truck knowing that he's going to split the proceeds of this overload with the driver.

Motives to steal may grow out of any one of a whole range of human emotions, ambitions, difficulties, desires. The traditional causes, and those which appeal to the public imagination, are sometimes called the three R's: rum, redheads and racing. A fourth cause, gaining prominence within the last few years is drug addiction.²

A study of more than 1,000 cases of business fraud in manufacturing plants, retail stores, wholesale outlets and other types of companies showed it is possible to consolidate and list the following as the principal, external factors which compel employees to steal:

- Living beyond means with no apparent effort to live within wages or salary earned;
- Gambling, high-living and questionable companions;
- Extended illness of the principal wage earner or a member of the employee's family".³

These quotations suggest various general motives for stealing. It is thought, however, that management fraud is more likely to be committed if certain specific psychological conditions exist. A widely accepted theory about fraudulent behavior is described below:

The fact is that management frauds, ... are generated by general cultural conditions over which accountants do not have, and cannot have, very much control.

...Given the fact of trust, made necessary by the nature of modern business, why is it that only some trusted people violate that trust?

...Why is it that only a minority of the persons possessing the freedom to deviate do in fact deviate?

...I developed, ... a generalization which I think applies to all the embezzlers I talked to ...

What I came up with was the idea that embezzlement involves a psychological process made up of three steps or phrases:

1. The feeling that a personal financial problem is unshareable.
2. The knowledge of how to solve the problem in secret, by violating a position of financial trust.
3. The ability to find a formula which describes the act of embezzling in words in which do not conflict with the image of oneself as a trusted person.
4. Individuals have unbearable financial problems if it appears to them that they cannot turn to ordinary, legitimate sources for funds. ... the trusted person is "ashamed" or "has too much false pride" to share the problem with people ordinarily available for help in financial matters, the problem must be kept secret. ...

It should be emphasized, however, that the possession of an unshareable problem is not alone the cause of embezzlement.¹

2. The second part of my generalization, the realization that the problem can be solved in secret by violating a trust, is a problem in the psychological perception of opportunities to embezzle. ... everyone in genuine position of trust has an objective opportunity to violate that trust. ... Yet many persons in trusted positions do not perceive that their unshareable problems can be resolved by violating the trust. Before they can do so, they must have certain general information about trust violation, and must be able to apply that general information to their own conduct in the present circumstances. ...
3. The third element in my generalization about the embezzlement process, verbalization, is the next crux of the matter. I am convinced that the words the potential embezzler uses in conversations with himself or herself are the most important elements in the process which gets the trusted person in trouble. ... If a person sees a possibility for embezzlement, it is because he or she has defined the relationship between the unshareable problem and an illegal solution in language that lets the person look on trust violation as something other than trust violation. If the person cannot do this, he or she does not become an embezzler.

To illustrate, let us imagine a man who is a pillar of the community, a respected, honest employee, a man with a background no more criminal than that of most of us. This man finds himself with an unshareable problem and an objective opportunity to steal money from his company. The chances are very good that if in that situation I walked up to him and said, "Jack, steal the money from your boss", he would look at me in horror, as if I had suggested that he could solve his problem by going down and sticking a pistol into the face of the local liquor store owner. "Jack, steal the money from your company", probably would bring about less of a horror reaction. Still, honest and trusted persons "just don't do such things". However, honest and trusted persons do "borrow", and if I were to suggest that Jack secretly "borrow" some money from his firm, I would have helped him over a tremendous hurdle. Then he can tell

himself that he is borrowing the money and can continue to believe that he is an honest citizen, even as he is stealing the boss blind. Because he wants to remain an honest citizen, the "borrowing" verbalization becomes the key to his dishonest conduct.

The "borrowing" verbalization is but a simple example of a vocabulary that can adjust two contradictory rules - the role of an honest person and the role of a crook. I call the use of such a vocabulary a rationalization... It is itself a motive, a set of words formulated before the act takes place, and which are themselves the person's reasons for acting. The rationalizations used by embezzlers vary with the position of trust which is involved and, also, significantly, to some extent with the precise manner in which the trust is violated.

... Embezzlers report the use of other rationalizations, such as the notion that theirs is a case of "necessity" ... or that their employers are cheating them, but these rationalizations are almost always used in conjunction with the "borrowing", "ownership", and "don't care verbalizations."¹

Common rationalizations include the following:

- It's all right to steal because:
- what he takes was going to be thrown away;
- he is only borrowing what he takes;
- he is underpaid and deserves what he is stealing;
- others are doing it;
- the owner (or company) is so big that what is taken will never be missed;
- the boss steals.⁴

Thus, the elements that must be present for crime to take place are:

Motivation Elements

- an economic or psychological need;
- a moral justification;

Situation Elements

- an opportunity;
 - a perceived low chance of detection.⁵
-

EMPLOYEE FRAUD/THEFT

The essential difference between executive dishonesty and "rank-and-file" dishonesty is that the executive dishonesty is always related to a violation of trust connected with the position. What makes this so important is the moral issue involved ...²

The essence of the Yale findings was that an act of theft is precipitated by the coming together of three factors in the life of the potential thief. Thus, a theft situation may be visualized as a triangle, with each side representing one of the three critical elements: 1) aggression; 2) frustration; and 3) low anticipation of being caught...

Often when people steal in a department, the cause of their frustration can be traced to the supervisor's failure to relate properly to his employees on a personal basis. He may be too authoritarian ... Or he may provoke theft because of his lack of consideration ... Unrealistic company policies can also lead to frustration.

The third side of the theft triangle, low anticipation of being caught, is the opportunity required to enable the aggressive and frustrated person to steal. "Anticipation" is the key word here. Fear of being caught is the greatest single deterrent to crime.⁶

Causes of Employee Theft

The causes of employee fraud and theft do not lie solely with the employee. The work environment created by the employer can have a strong influence as well. Employee thefts have been found to occur more frequently in those companies where communication between management and its employees is poor.

Some patterns of dishonesty clustered around four levels of activity:

The four levels were categorized as follows:

<u>GROUP</u>	<u>APPROXIMATE NUMBER OF DISHONEST EMPLOYEES, PERCENT</u>	<u>SITUATION</u>
A	90 to 98	Dishonesty and vandalism causes serious disruption of business
B	60 to 75	Dishonesty and vandalism is overt manner.
C	20 to 30	Some dishonest/no vandalism.
D	up to 3	No dishonesty/no vandalism.

Obviously these discoveries were not only surprising to me, but the potential they offered was dramatically apparent. Now I needed to determine what elements of similarity or of difference existed between the four categories of companies...

All of the firms with practically no internal thefts had excellent formal and informal training programs. ... In other words, formalized ongoing training of all executives in the company was one of the crucial differences between the "D" group and the undesirable situations in groups "A" and "B".

In the "C" style of management I found that managers have a substantial confidence and trust in their subordinates. ... In both the "C" and "D" firms, subordinates felt free to discuss things about their job with their boss and without fear of retribution. ...⁷

... Dishonesty is a problem in human relations, and top management's attitudes and policies contribute to this problem. In order for a high ethical standard to be maintained, top management must set the example. ...²

It is clear that management can do much to reduce the likelihood of employee frauds or thefts.

CHARACTERISTICS OF WHITE COLLAR CRIMINALS

Some research has been done in the United States to try to establish whether or not the individual who becomes labeled as a white-collar criminal is any different from other members of the public.

White-Collar Criminals and Property Offenders

Even though it has been suggested that white-collar criminals are different from other criminals, there does not appear to be any published evidence supporting this conclusion. The impression of some members of our research team was that white-collar offenders are more like normal citizens than like the other prisoners. ...

White-collar criminals were selected who committed crimes against their employers which usually involved embezzlement of more than \$5,000. Property offenders were those involved in burglary, theft and robbery. The sample included 667 property offenders and 42 white-collar criminals from a national prison sample and the Utah State Prison. In analyzing the data, we found the following:

1. White-collar criminals were considerably older than other property offenders. This makes sense since they must have worked into a position where there was an opportunity to commit fraud.
2. A higher proportion of white-collar criminals were female.
3. None of the white-collar criminals was tattooed, whereas 61 percent of the other property offenders was tattooed.
4. The proportion of white-collar criminals who were divorced was much lower than the proportion of other property offenders who were divorced. It appeared that most white-collar criminals led more happy lives.
5. White-collar criminals had much more education than other property offenders.
6. White-collar criminals were much less likely to have used drugs than other property offenders.

7. On an average, a much higher proportion of white-collar offenders were members of some religion than were the other property offenders.
8. The white-collar offenders had several fewer entries on their "rap" sheets (arrests and conviction records) than did other property offenders.
9. The white-collar offenders had much higher IQs than did other property offenders.

The results of the psychological tests showed that white-collar criminals scored much higher than other property offenders in measures of self-esteem, self-sufficiency, achievement, motivation, social conformity, self-control, kindness, empathy, optimism and family harmony.

We also compared the test scores of our white-collar criminals with those of a sample of college students. It was found that there were only six personality scales that produced significant differences between the incarcerated white-collar criminal and the college student. On three of the scales the white-collar criminals scored more pathologically than the students, while students scored worse on the other three. Overall, the white-collar criminals' personality scores were much more similar to those of the students than to those of other property offenders.

In examining these results, we tentatively concluded that white-collar criminals are much more like the average person than they are like other property offenders. ...¹

As forensic accountants, we do not specialize in the psychology of human behavior. Nevertheless, investigators need to be aware of the human dimensions of economic crime since they must deal with the results. Limited and tentative though research findings are, it is worth being aware of what is known about the motives for dishonesty, the conditions that promote it, and the characteristics of white-collar criminals.

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FORENSIC APPROACH

Considers the

HUMAN Perspective

WHY DO HONEST PEOPLE STEAL?

EMPLOYEE LEVEL

Why:

Need: **personal problems due to
health, drugs, finances**

Justification: **due to poor management**

MANAGEMENT LEVEL

Survival: **corporate situational pressure
creates the hope syndrome**

**WHY DO DISHONEST PEOPLE
STEAL?**

EMPLOYEE LEVEL

How:

**Opportunity: greed and low morality, low risk
 of being caught**

MANAGEMENT LEVEL

Opportunity:	Greed:	money
	Ego:	community profile
		corporate profile

FORENSIC APPROACH

Why do honest people steal?

Know Your Company, Your People and Fraud

REGINA VS CAMPBELL AND MOTTRAM

Robert Campbell

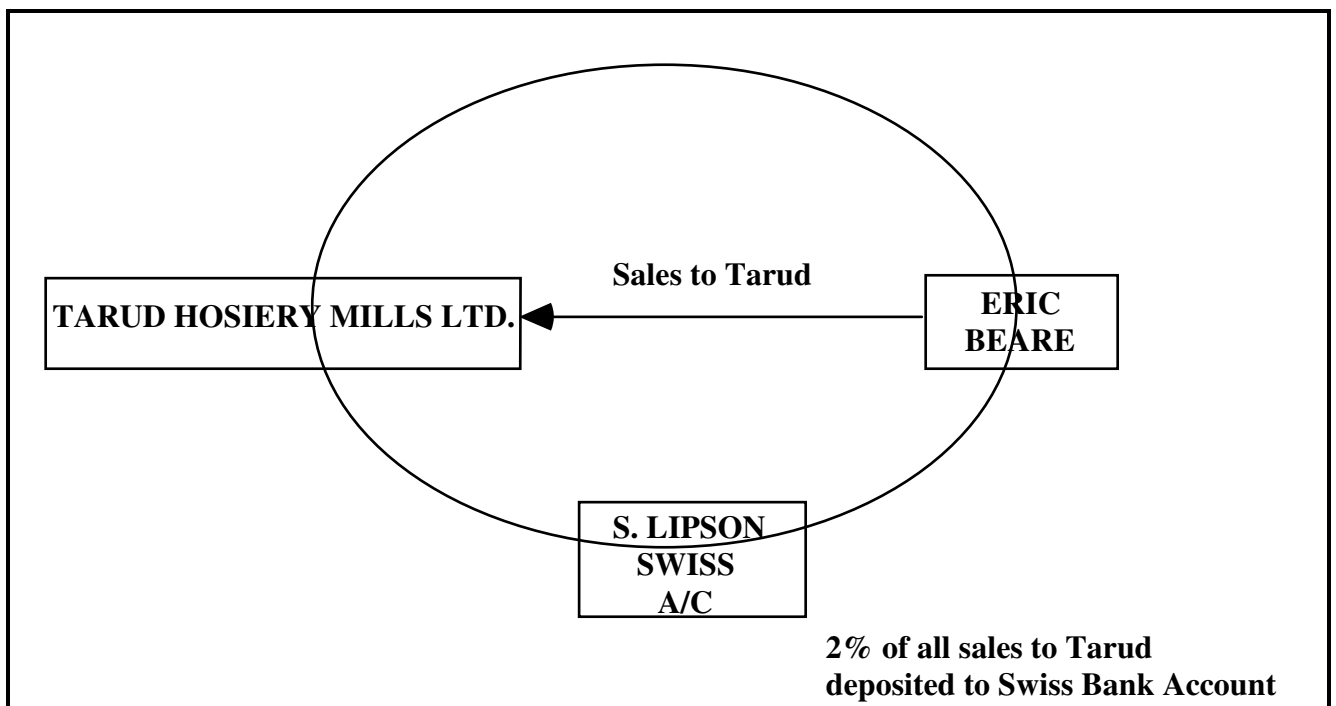
- **Director of purchasing for Woolco**
- **Trusted employee**

Thomas Mottram

- **Manufacturers' sales agent to Woolco**
- **Woolco was 50% of business**

R. VS. LIPSON

**President of Tarud, S. Lipson
Approvals Sales Invoices**



FRAUD AWARENESS

- **Know your company and industry**
- **Know your people**
- **Know the subject of fraud**

KNOW YOUR COMPANY - REALITY

SITUATION PRESSURES??

- **Extremely rapid expansion**
- **Heavy investments or losses**
- **Unusually high debt**
- **Insufficient working capital**
- **Urgent need for favorable earnings**
- **Dependence upon only one or two products**
- **Dependence upon only one or two customers**
- **Unusual change in vendors**
- **Inadequate disclosure of unusual business arrangements**
- **Impression of customer exceeds reality check**

KNOW YOUR PEOPLE

Situation Pressures?

- **Living beyond means**
- **Emotional instability / marital problems**
- **Drinking or drug problem**
- **Gambler / Chronic liar**
- **Behavioral changes**
- **Corporate or peer group pressures**
- **Undue family, community or social expectations**
- **Refuses generous retirement package**
- **Overly attentive to your involvement**

- **Frustrated long term employee**
- **Questionable associates / vendors**
- **Respect for policies and procedures?**
- **Pay raise commensurate with employment?**
- **Compliance with job description**
- **Ego**
- **Unusual demands of expediency or playful delay**
- **Desire for exclusive contact**

KNOW YOUR PEOPLE

- **Unusually high personal debt**
- **Severe personal financial losses**
- **Increasingly large shareholder loans from company**
- **Extensive involvement in speculative investments**
- **Involved in side businesses**
- **Defendant in a lawsuit**

KNOW YOUR PEOPLE

- **Lack of ethics**
- **Wheeler dealer attitude**
- **Unreliable communications / actions**
- **Questionable associates**
- **Unwillingness to disclose information**

KNOW YOUR CUSTOMER - INTEGRITY

**CRESSEY SUGGESTS THE CRITICAL
ELEMENTS FOUND IN WHITE-COLLAR
CRIME ARE:**

- **A non-sharable problem**
- **An opportunity for trust violation**
- **A set of rationalizations**

KNOW FRAUD

What does Fraud look like?

- **Management Override**
- **Changing Relationships**
- **Bad Management**
- **Third Party Relationships**
- **Corrupt Management**

Learn to Recognize the Signs of Fraud

**How do you address the Opportunities
and Resources in Today's
Business / Government Environment?**

Some thoughts:

Opportunities:

- **Key positions of trust should be filled by individuals with high personal integrity**
- **Up-to-date organization summaries and internal systems**
- **Monitor relationship with third parties.**

Pressures:

- **Create climate of Openness and Trust**
- **Allow management and employees to set realistic goals**
- **Establish a communication / safety net system for management and employees in personal difficulty.**

Common Thread

- **A concern for others**
- **Common (and a 6th) sense**
- **Same rules for everybody**

DEFINITION OF FORENSIC ACCOUNTING

Webster's dictionary - definition of "forensic"

"Belonging to, used in, or suitable to courts of judicature or to public discussions and debate"

Webster's dictionary - definition of "role of the accountant"

An individual who "furnish[es] a justifying analysis or explanation"

STANDARDS

- **No published generally accepted forensic accounting standards**
- **Actual standard is that required by a court of law**
- **Subject to cross examination**
- **Every point must hold up**

DANGERS

- **Exposure on stand**
- **Loss of reputation**
- **Worsen the problem**
- **Liability**
- **Becoming too close to the forest**

This work impacts directly on people and their lives.

WHAT IS A FORENSIC ACCOUNTING

A forensic accountant is

- **an identifier of issues**
- **a gatherer of information**
- **an analyst of documentation**
- **an analyst of people**
- **a financial investigator**
- **a reporter**
- **an expert witness**

FORENSIC ACCOUNTANT'S EQUIPMENT

Professional Skills and Attributes

- **Accounting and audit knowledge;**
- **Fraud knowledge;**
- **Knowledge of law and rules of evidence;**
- **Investigative mentality and critical skepticism;**
- **Understanding of psychology and motivation;**
- **Communication skills; and**
- **Understanding of computers and information technology.**

Ethics

- **Independence and Objectivity**
- **Respect for Access to Information and Privacy Laws**

EXPERTISE

Understand the standard of proof

- **what is relevant**
- **how far to go**
- **what to investigate**

EXPERTISE

Must be

- **objective**
- **able to see both sides**

Cannot be

- **influenced by client**

THE WHOLE STORY

Client needs are served by

- **the good news**

and

- **the bad news**

FORENSIC APPROACH

Application of an

Investigative

Mentality

FORENSIC APPROACH MINDSET

"Often, the fraud auditor does not know what he is looking for or even why, other than something looks suspicious or out of place.

So being over organized when doing fraud audit work may be a handicap. You need a lot of freedom and space to let your imagination run wild. You need to poke holes into everything including your own pet theories and biases. do not accept anything, anyone says as gospel truth. Do not assume that any document is what it purports to be. When conflicts between statements of witnesses occur, do not take sides or prejudge their veracity. Keep an open mind. The proof of fraud is rarely where and what you thought it was when you first began the audit. Preconceptions are dangerous. They invariably lead you down the wrong tracks."

**"Fraud Auditing and Forensic Accounting
New Tools and Techniques" by Jack
Bologna and Robert Lindquist**

INVESTIGATIVE MENTALITY

- 1. Is skeptical of the integrity of management or employees**
- 2. Is skeptical of the integrity of documents**
- 3. Is skeptical of sampling - often a review of the whole population can disclose pattern**
- 4. Is not concerned with materiality -
immaterial amounts may reflect improper behavior or may be the tip of the iceberg**
- 5. Pursues more vigorously third-party documentation and interviews**
- 6. Seeks alternative explanations of accounting transactions - tests in relation to business reality**
- 7. Gives benefit of doubt to the other side**

INVESTIGATIVE MENTALITY (1)

Scope is not restricted by:

- **materiality**
- **sampling**
- **integrity of:**
 - **management**
 - **documentation**

INVESTIGATIVE MENTALITY (2)

Seeks out evidence:

- **knowledge of best evidence**
- **alternative sources**
- **interviews**

INVESTIGATIVE MENTALITY (3)

Seeks alternate explanations:

- **logical suggestions**
- **tests business reality**
- **tests explanations**
- **considers benefit of doubt
(after assessing all evidence)**

CHARACTERISTICS OF THE INVESTIGATOR

- **Imagination**
- **Curiosity**
- **Skepticism**
- **Keen nose**
- **Sensitive to form vs. substance**

INVESTIGATIVE CONCERNS - 1

The investigation itself

- **objective and scope**
- **timing**
- **resources / expertise required**
- **third party documents required**
- **interviews necessary**

INVESTIGATIVE CONCERNS - 2

The perpetrator(s)

- **motive**
- **opportunity**
- **pattern of conduct**
- **lifestyle and evidence thereof**
- **not to alert**
- **not to prejudice rights of an insurer**

INVESTIGATIVE CONCERNS - 3

The evidence

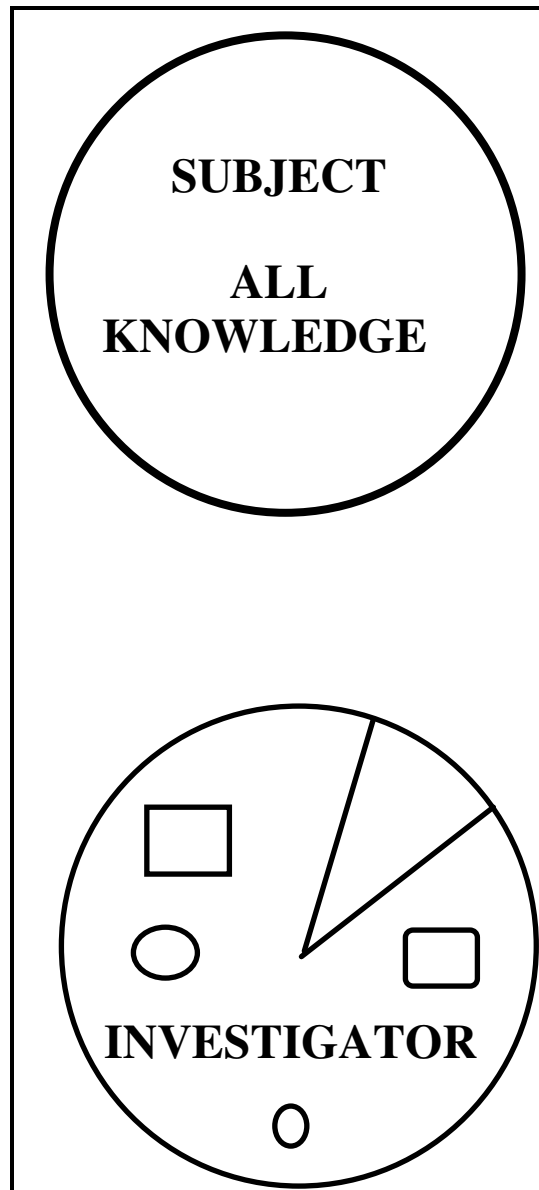
- **protection of evidence and assets**
- **alteration or destruction of records**
- **searches for evidence**
- **statements**
- **confessions and admissibility**

INVESTIGATIVE CONCERNS - 4

The evidence

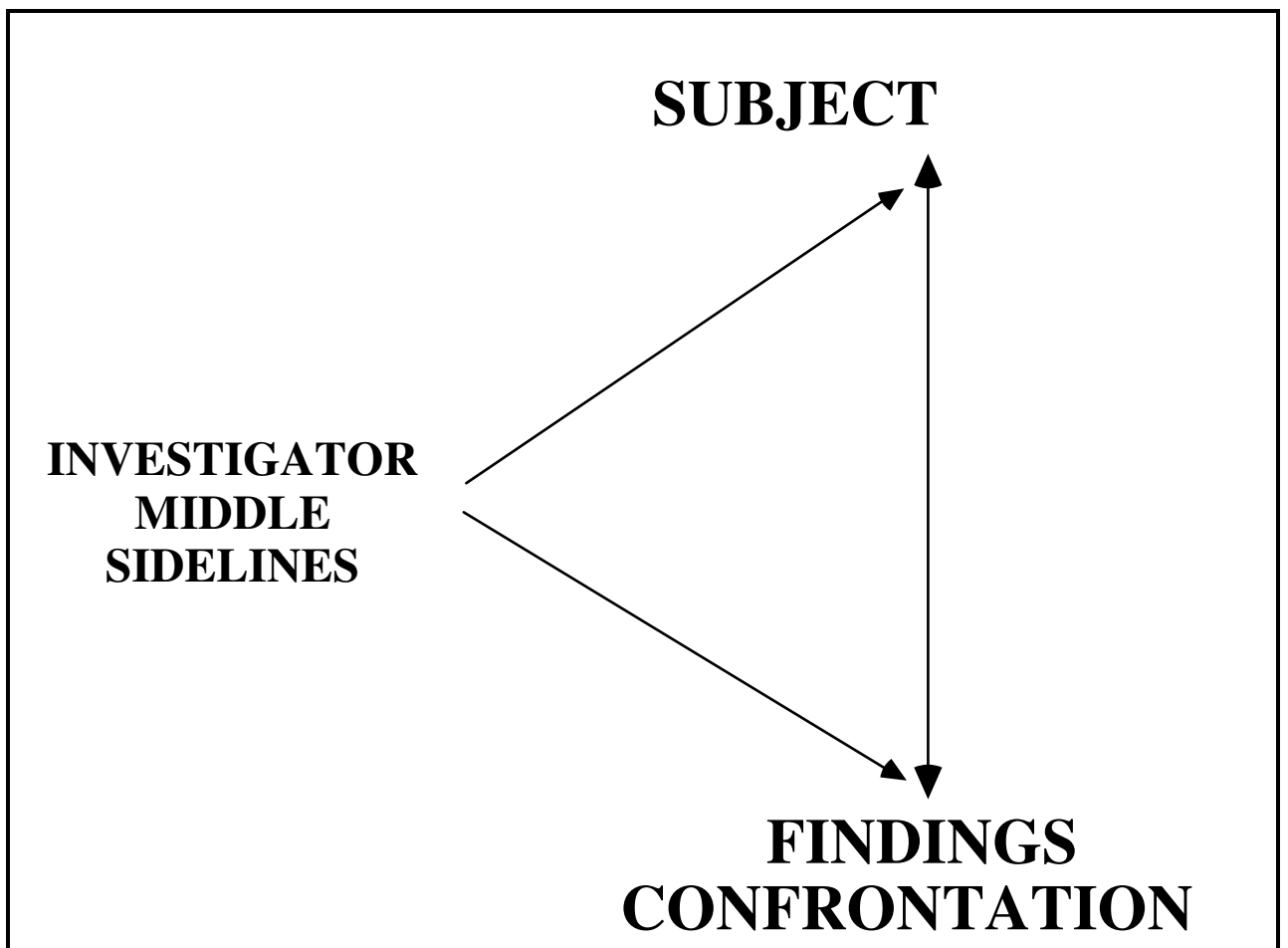
- **standard of proof**
- **summaries of evidence**
- **conclusions**
- **communication of findings**

THE PUZZLE GAME



PUZZLE PIECES

POSITIONING



QUESTIONS THAT MAY ARISE DURING EMPLOYEE INTERVIEWS

- Q: What is the purpose of this investigation?**
- Q: What is the real purpose of this investigation?**
- Q: Does management believe someone in this department has engaged in any misconduct or criminal activity?**
- Q: Am I suspected of wrongdoing or misconduct?**
- Q: Could I lose my job? or Is my job in jeopardy?**
- Q: Assuming I cooperate, will I be guaranteed employment?**
- Q: Why are there so many investigators here?**
- Q: How long will the audit take?**

Q: What if I am threatened outside of the company?

Q: How do you know so much already?

Q: Are you saying my job will be in jeopardy if I don't stay and answer your questions?

Q: I am not feeling well.

Q: I am going to retire.

Q : I quit.

Q: I am leaving right now.

INTERVIEWING TECHNIQUES

- **Purpose of Interview**
- **Preparation**
- **Conducting the Interview**
- **Qualities of a Good Interviewer**
- **Summary**

PREPARATION

- **Timing**
- **Physical and emotional needs**
- **Preparation**
- **Privacy**
- **Eliminate physical barriers**

PREPARATION

An interview must be planned and started on a sound footing.

- a. Timing - conduct the interview as soon after the incident as possible.**
- b. Physical and emotional needs - calm the excited or the emotionally upset witness, consider the subject's physical comfort before commencing the interview.**
- c. Preparation - do not be stampeded into an interview. Obtain the facts and as much background information as possible before starting.**
- d. Privacy - select the location which will not distract the subject.**
- e. Eliminate physical barriers - do not allow physical objects (desk) to separate you from your subject.**

CONDUCTING THE INTERVIEW

- **Getting acquainted**
- **Keep the subject talking**
- **Listening**
- **Ending the interview**

CONDUCTING THE INTERVIEW

A. Getting Acquainted - your approach may either be formal or informal depending upon the person being interviewed.

- **Allow the subject to become accustomed to you and to the surroundings.**
- **Common sense dictates that a point of conversation should not be brought up unless you can discuss it with ease and to talk about matters tailored to their interests and activities.**
- **Try to develop a rapport by displaying a sincere interest in the subject.**

B. Keep the Subject Talking - after you notice the interviewee is in a communicative mood, turn his attention to the information you are seeking.

- **Questions such as know about the incident, please tell me all you know, can steer the interview to the desired topic.**
- **Allow the subject to give a complete account without interruption.**
- **Your primary purpose is to keep the subject talking.**

C. Listen to what is said and how it is said.

- **The interviewer must also evaluate the person in a conversation, it is not always what a person says that is important, but the manner in which it is said or what is not said that bears importance.**
 - **Sudden silence should be recognized, this can be a sign that the interviewee may be deliberating whether he should share the information with the interviewer. This may also indicate that a sensitive area has been reached.**
 - **Bodily responses often betray the emotional stress of a subject.**
 - **Avoid questions that will result in a yes or no answer.**
- D. Ending the Interview - close the conversation in a courteous and friendly manner.**
- **You may wish to summarize what has been covered and ask the subject if there is anything else you may wish to add.**
 - **Extending common courtesy and good manners helps assure a future cooperation for further interviews or testimony that may be required.**

QUALITIES OF GOOD INTERVIEWER

- **Organized**
- **Good researcher**
- **Understanding**
- **Criteria of proof**
- **Know what he is talking about**
- **Good listener**

QUALITIES OF A GOOD INTERVIEWER

- **Must be organized and project a good image.**
- **Must be a good researcher.**
- **Must see and understand how each transaction relates to another.**
- **Must know the criteria of proof required.**
- **Must look like he knows what he is talking about without being offensive.**
- **Good listener.**

INVESTIGATIVE APPROACH

Internal Documentation

- **Groundwork for other sources of information**
- **Obtain original documentation**
- **Preserve integrity of document**

INTERNAL DOCUMENTATION

In conducting an investigation, one source of information that you will turn to are internal documents.

Internal documentation should be reviewed to:

- **Provide additional information;**
- **Confirm information currently held;**
- **Corroborate management disclosure and documentation.**

If the internal information indicates that a fraud may have been committed or alternatively does not provide conclusive evidence, it will form the ground work in seeking out other sources of information.

When compiling a file for an investigation, it is recommended that original documentation be obtained rather than copies and to ensure that the information is not marked or altered during the investigation process.

Internal Documentation

- **One source of information**
- **Will provide additional information**
- **Confirm current findings**
- **Corroborate management disclosures**

In compiling a file:

- **Obtain original documents**
- **Do not mark up or alter documents**

INVESTIGATIVE APPROACH

Pursuing Third Party Documentation

- **Sources other than interviewing**
 - **Suppliers**
 - **Customers**
 - **Competitors**
 - **Joint Venture Partners**
 - **Means Test**
 - **Corporate Registry Services**
 - **Title Searches**
 - **Physical Verification**
 - **Credit Checks**

- **"Right to Audit" clauses**

THIRD PARTY DOCUMENTATION AND FOLLOW-UP

While a fraud is occasionally revealed through internal oriented investigation, the chances of detection can be increased by obtaining third party documentation either from external or independent sources.

With third party details in hand, a full and complete evaluation is possible to assess the in-house documentation in comparison with third party documentation. Third party documentation allows the forensic accountant to test the honesty of the situation and the business reality of the information obtained internally.

A source of information which can prove valuable is the comments provided by third party staff. Interviews of the staff, therefore, are a valuable tool and it is important that the forensic accountant is adequately trained in interview technique designed to ferret out all relevant information.

An actual example where we were involved related to a vendor audit. During the interview of the vendor, almost in an effort to move us away from his activities, he indicated that a competitor had obtained a significant construction contract (which he was bidding on) only because of a related party involvement with the company we were assisting.

Utilizing this information and a further vendor audit, it was confirmed that a conflict of interest situation had developed and the company we represented had drastically overpaid for the construction contract. Appropriate action was then taken to rectify the situation to the extent possible.

While there is not a clear cut method for solving a fraud, the forensic accountant can go a long way in achieving this goal by utilizing to greater extent third party information and persistently following up on all exceptions and inconsistencies with internal documentation.

PURSUIING THIRD PARTY DOCUMENTATION

As previously discussed, pursuing third party documentation as additional corroboration to vital internal information should be a standard procedure in an investigative audit strategy.

While we have stressed the importance of interviews of staff external to the company, other sources of information are also useful.

The following sets out some sources that may be utilized:

- Vendors/Suppliers**
- Customers**
- Competitors**
- Libraries**
- Joint Venture Partners**
- Credit Organizations**
- Police**
- Associated Companies**
- Legal Advisers**
- Qualified Experts**
- External Auditors**
- Banks**
- Government Registers**

Generally, all companies have inserted standard "right to audit" clauses in their work order documentation or vendor contracts. The "right to audit" clause provides relatively easy access to a vendor's records for the purposes of conducting an investigation. In addition, many contracts relating to joint ventures, long-term supply agreements and leases have clauses allowing access to a company's financial and administrative records.

These sources should be utilized to the fullest extent in designing your investigation.

Given the various requirements of your investigation, it is impossible to identify all the potential external sources that are available to the forensic accountant. You should take these into consideration as they will increase your awareness of the possibility of fraud in your investigation without adding significantly in terms of time or cost.

DOCUMENTARY EVIDENCE IDENTIFICATION AND CONTROL

- **Determination of the time period**
- **Primary evidence requirements**
- **Handling and cataloguing the documents**

Determination of the Time Period

Determination of the time period is an initial step in obtaining evidence for your investigation. The time period must be defined early in the investigative process, however, it can be contracted or expanded depending upon the findings from your investigation. In the case where the time period is a relatively unknown, the time period is often set within a number of months/years when it is alleged the crime was committed.

Once your review of the evidence determines the initial substance of the allegation you may then expand your time period. It is not uncommon in an investigation to expand the time period from the initial review of records relating to a number of months to a number of years. The constraint in terms of your investigation can be the availability of records and their location. On the other hand the time period can also be expanded based upon the modus operandi of the accused and the requirement to establish benefit.

Financial Documentation - Primary Evidence Requirements

The minimum requirements for financial documentation are likely to be the following:

- **documentation pertaining to the movement of assets into and out of a company for the period under investigation;**
- **books of account, management reports, statistical analysis pertaining either to the management of the company or to an individual for the period under investigation;**
- **relevant correspondence including internal memos, letters, personnel files, payroll, and records;**
- **personal documentation such as bank account records.**

Asset Detail

A summary of internal documents often useful in completing your investigation concerning a theft or fraud within a company may include the following:

- **Credit/Debit/Memo Account Entries**
- **General Ledger/Trial Balance**
- **Expense Reports**
- **Bank Account Statements and Transaction Listing**
- **Personnel Files**

- **Payroll Files**
- **Corporate Code of Conduct/Policy**
- **Annual Employee Declaration**

Sources of external documentation often useful in gathering evidence regarding a theft or fraud investigation may include the following:

- **Written statements regarding the allegation**
- **Land Titles**
- **Corporate Registry**
- **Credit Organizations**

Handling and Cataloguing the Documents

Documents under your care, custody, and control must be handled carefully. The documents should not be written upon, altered, stapled or unstapled during the course of your investigation. Often a notation is entered on the back side of a document as to time, date, place, and description.

Original documents obtained by yourself should be properly identified and catalogued.

The documents should be examined in detail and categorized as follows:

- **documents required for evidence (categorized by time, description, purpose);**
- **documents required by rebuttal of the defense arguments;**
- **documents required for other reasons; and**
- **documents of no specific use.**

Once the documents have been sorted into these groups, photocopies can be made to provide working copies to use when preparing schedules, for use when completing interviews, and in general for working paper files.

In criminal proceedings documents will be subsequently selected, from among these photocopies, which will be relied upon for the presentation of evidence in a court of law. These documents should be compiled and assembled in a document brief.

Dependent upon the number of documents, it is often appropriate to utilize a computerized database management system ("DBMS") to aid in the control of documents. A DBMS offers the following advantage:

- ease of document control in situations where there are numerous documents;**
- quick retrieval of relevant documents;**
- complete identification of all documents related to a specific parameter.**

PRESERVATION OF DOCUMENTARY EVIDENCE

- **Identification of critical sources**
- **Identification of sources subject to destruction**
- **Evidence held by defendant**
- **Use of original documents**
- **Acceptability of copies**
- **Storage / Safekeeping requirements**

Identification of Sources Critical and/or Subject to Evidence Destruction

Upon the determination of your requirements and the type of wrongdoing, it is important then to turn one's attention to the identification of evidence critical to your investigation. In priority of importance the evidence requirements should be identified and steps then taken to secure the evidence.

Sources of evidence critical to your investigation should be approached initially to confirm that the evidence is available and accessible. Without initial confirmation of the above, valuable time and effort may be expended without producing results. Additionally, sources of evidence where the evidence may be subject to normal destruction procedures must be identified and steps taken to ensure the required records are obtained on a timely basis.

Evidence Held by Defendant and Subject to Destruction

Often the situation will arise when incriminatory documentation is held by the defendant in a civil action. In this situation the fear is that the evidence may be destroyed so that the defendant can by "uniform means" frustrate the litigation process before any applications can be made.

Fortunately, there are solutions available to the plaintiff through the courts. The use of the court orders today has evolved to situations where it will restrain the defendant from destroying or removing any of the material covered by the order or warning any third party of the existence of the order. The order is extremely useful in situations where action must be taken by the plaintiff quickly and without notice to the defendant.

In order to obtain an Order, the Court has to be satisfied as to the following:

- **extremely strong prima facie case against the defendants;**
- **demonstration that the potential or actual damages to the plaintiff is significant;**
- **clear evidence that the defendant has incriminating documents or things in his possession;**
- **real possibility that this documentation or evidence will be destroyed so that the defendant can by "unfair means" frustrate the litigation process before any applications can be made.**

Use of Original Documents/Acceptability of Copies

A general principle followed is that the best evidence that can be produced, should be produced. This principle is followed then in requiring that original documents be produced as evidence. However, many corporations are sensitive to the release of original records given the requirements for corporate statutes, by-laws, tax considerations and confidentiality.

There may be a method where a company may maintain confidentiality of a document through the use of a "sealed exhibit". If control of original documentation is extreme, a copy of records, endorsed as true copy by the corporation is often acceptable to the Courts.

Documents when received should be initialed on the back as to source, who seized and date of such.

Storage/Safekeeping Requirements

Protection from Alteration

Access to evidence important to your investigation must be controlled to prevent planned alteration of the records. It is important, therefore, to obtain control of records that you require completing your investigation in the early states. Consideration should be given to the removal of sensitive documents and files from the general working area of your office.

In dealing with sensitive files it may be prudent to establish separate access controls and document the access of individuals to the records through a sign in/out procedure.

Protection from Destruction

Records normally subject to routine destruction which may be required must be identified in the early stages of your investigation to prevent destruction. Additionally, proper safeguards must be taken to prevent the planned destruction of records where it is designed to impede or frustrate your investigation. These safeguards include the identification of documents that could easily be destroyed or removed and protecting such through access controls.

FINANCIAL ANALYSIS AND SYNTHESIS

- **Detailed analysis of financial issues**
- **Use of data bases to track documents, transactions and themes**
- **Assessment of the quantum**
- **Determination of patterns**
- **Integrate human perspective**
- **Assessment of possible mens rea**

EXPERTISE

Understand the standard of proof

- **what is relevant**
- **how far to go**
- **what to investigate**

Objective:

Find out the answer; preserve the integrity of the organization and the individual within the organization who is the subject.

Considerations:

People

- **Protect your informant. This is most important.**
- **Limit the number of people who need to know to maintain purity.**
- **Limit the number of people who will pursue it to maintain control.**
- **Ascertain quality and source of information regarding the questionable issue - How do you do that and with whom? Identify nature of problem and set approach.**

Approach

- **Keep things in balance and proper perspective. Don't convict.**
- **Understand your natural bias.**
- **How useful / crucial is third party independence to the investigation.**
- **Is it internal only or a combination of internal and external people?**
- **Should background information be obtained.**
- **If innocent will that person still be a meaningful contributor to your company - how can you ensure that?**
- **When should the targeted individual be approached due to concern over constructive dismissal (timing of confrontation)?**
- **How do you preserve the integrity of the targeted person since the answers might only be found in his home - in personal records?**

Assessment

- **Do you have immediate security problems?**
- **Should a public statement be made and if yes when?**
- **Should the Board be made aware? the audit committee? counsel? security ? others?**
- **What regulatory groups should be advised?**
- **Do you notify your insurer?**

Investigation

- **Can you establish privilege over your work product?**
- **How do you document your findings including interviews?**
- **When should you access the personnel file?**
- **Should the desk be searched? the brief case?**

- **Should documents be examined at night and copied?**
- **What constitutes best evidence and its preservation of both witness and document evidence?**
- **Do you know how to preserve for court an immediate confession?**
- **How far do you investigate before you are satisfied allegations are true or false?**

CASE STUDY

- **Technology Manufacturer**
- **On going problem of finished goods escaping into grey market**
- **Suspect:**
The realization group who are responsible for disposal of old technology

INTERVIEWING

ASSESS:

HONESTY

GROUP CHEMISTRY

EGO

IDENTIFY:

CONTROL GROUP

ROLES

ROLLOVER CANDIDATES

PHYSICAL POSITIONING

INTERVIEW APPROACH

<u>RANK</u>	<u>PERSON</u>	<u>SEQUENCE</u>
1	ST	1
2	BONGO	4
3	EDDY	2
	BID ANALYSIS	
4	LOUISE	3
	BID DOCUMENTS	

APPROACH TIMING

FEBRUARY	24	ST
	25	EDDY
	25	LOUISE
	26	BONGO
MARCH	23	ST
APRIL	2	BONGO
	2	ST AND COUNSEL
	6	ST
	6	MUTUAL MEETING
	14	INFORMANT

AUDIT ENVIRONMENT

Credibility was Always an Issue

- **Controlled Information Flow**
- **Changing Recollection of Facts**
- **Potential of Rehearsed Answers**
- **One Individual Instructed**
 - **"Do not show them that."**
- **"Us vs. Them"**

Protecting the Bottom Line: An Effective Fraud Prevention & Detection Strategy

By Mario Possamai

1.0 Introduction

If fraud takes root where the ground is fertile, then we must live in an era of especially rich soil: it's estimated that fraud costs the North American economy more than \$100 billion a year.

But the cost of fraud is much more than just the amount of money that might have been misappropriated.

Companies that are victims of fraud bear the cost of investigating the fraud, of clearing up the problem and of ensuring that there's no recurrence.

Losses due to fraud may lead to layoffs, plant closures or even business failures.

Companies defrauded of funds may miss business opportunities. The misappropriated capital could have been used to create employment, build new facilities or develop better products and services.

Fraud also exacts a huge personal cost. It can have a traumatic effect on individuals, leading, in some cases, to marriage breakups, nervous disorders and even suicide.

Yet, despite the huge burden that fraud imposes on society, governments and law enforcement have fewer and fewer resources to combat it.

The result: never before has so much of the onus to fight fraud been placed on individual business persons and companies. Never have the stakes been higher.

No one is immune to fraud.

A business, agency or individual that thinks it's invulnerable to fraud is, in fact, the most inviting to fraudsters. Too often, complacency is the fraudster's best ally.

Conversely, the fraudster's toughest foe – indeed his worst nightmare – is a potential target that turns out to be both vigilant and well prepared to meet this challenge.

By implementing an effective fraud detection and prevention program, businesses, agencies and individuals can vigorously protect their bottom line.

2.0 A case study of complacency: Air Tech

Air Tech is a pseudonym for a multi-national corporation that fell victim to fraud.

A leader in the aeronautics industry, Air Tech prided itself in being a first-class organization. But there was one key chink in its armor: its executives believed they couldn't be defrauded.

Air Tech had a very good, lengthy relationship with a company that was a leader in the field of aircraft parts supply. Its products were more technologically advanced than the competition. Over the years, Air Tech and this supplier had treated each other fairly and had prospered together.

In the late 1980s, after a major corporate re-organization, a new group of individuals took over Air Tech's parts procurement department. This group had worked together in engineering design prior to working in procurement. Soon after they started in procurement, they decided to look for new suppliers. They told everyone: "We want to see if we could get a better deal for the corporation." Or, at least, that was their stated purpose.

Bids were tendered. This was a very complex exercise involving dozens and dozens of categories of parts. To prepare a price in each category required a great deal of technical knowledge and experience. The bidders had a very short time frame – just a few weeks – to submit their documents.

The existing supplier and other established firms in that field put in their bids. So did a newcomer with no track record in this area. The newcomer had made a slightly better bid in every category. Its bid was accepted.

This was surprising for a number of reasons. First, it didn't make sense that the newcomer could prepare such a complex document in such a short period of time. And second, how could it

consistently underbid the existing supplier by just enough to make a difference?

What no one knew was that the newcomer had inside help.

Moreover, no one had checked to make sure that the newcomer had the facilities necessary to meet the terms of the contract. When it made its bid, for example, its lone facility was in an inadequate site in an old shopping center.

Nor had anyone done a proper due diligence on the owners and executives of the newcomer. If they had, they would have discovered that one of its top officials was close to some questionable people well known to law enforcement.

The bottom line: Air Tech had been complacent about fraud. It didn't believe fraud could happen to it. But it got stung, failing to detect and prevent millions of dollars of fraud.

Air Tech also expended a great deal of time, energy and money to clear this up.

Not surprisingly, morale was affected, too. A number of managers had long been concerned about this rogue procurement unit. When they spoke up, no one listened. Others were too afraid to say anything. One result of the company's failure to respond was that many employees developed misgivings about their company's moral fiber.

Since then, Air Tech has taken a much more proactive approach to fraud detection and prevention, one that embodies the concepts outlined in this paper.

3.0 Fraud Prevention and Detection: An Effective Strategy

3.1 Overview

Eliminating the risk of fraud is virtually impossible. But you can sharply reduce your exposure through an effective prevention and detection strategy.

To realize this goal three key factors need to be addressed:

- The level of motivation of an individual, or individuals, to perpetrate a fraud;
- The opportunity which exists to commit fraud; and
- The risk of detection and punishment.

A business environment is vulnerable to fraud if the motivation of the potential fraudster is high, the opportunity for fraud is great, the risk of detection low and the threat of punishment non-existent.

3.2 Motivation to Commit Fraud

People commit fraud for many reasons.

Greed is the most common reason, and is self-explanatory.

Another is need. It is usually financial and is often related to addictive or compulsive behavior such as drugs, alcohol and gambling. However, it can also arise out of a need to maintain a certain appearance of success. For example, a senior executive accustomed to living the high life – who is experiencing business failures or excessive debts – may commit fraud in order to keep up the guise of wealth and power.

Individuals may also commit fraud out of a desire for revenge. This often involves someone who feels he or she has been exploited, abused or discriminated against.

3.3 Opportunity

The risk of fraud rises substantially where sufficient motivation to commit fraud coincides with a low-risk opportunity to do so.

This is especially important since it is generally accepted within fraud prevention circles that a small percentage of individuals – perhaps one in five – are inherently honest. A similar percentage are thought to be inherently dishonest. The rest are somewhere in the middle. Members of this latter group are typically “as honest as the situation dictates,” to quote *The Accountant's Handbook of Fraud & Commercial Crime*, by G. Jack Bologna, Robert J. Lindquist and Joseph T. Wells.

An effective prevention strategy seeks to reduce the opportunity to commit fraud by individuals who are either inherently dishonest or “as honest as the situation dictates.”

Some examples of what makes an environment vulnerable to fraudulent activity:

- Instead of implementing reasonable controls, the company trusts that employees will act honestly;
- Management can override internal controls; and
- There is no code of ethics (which everyone should have to sign).

If the expectation of being caught is low, it suggests the company has non-existent, weak or unenforced controls. Employees know the internal control systems and how they can be circumvented.

3.4 Reducing the Risk of Fraud

To reduce the risk of fraud, one essential step is to implement sound management practices that foster a positive, ethical work environment.

This includes such elements as:

- Screening all hirings carefully, and checking references. A surprising number of companies do not do that;
- Treating employees fairly. Positive human resources policies eliminate or reduce the factors that cause some personnel to commit fraud; and
- Establishing an environment where ethical behavior is valued and encouraged. This can be done through employee education, implementing a code of ethics, and establishing a fraud policy. But perhaps the most important factor is that clear direction must come from the top. Managers and executives must practice what they preach. If there's a double-standard, it won't work.

It is also important to reduce the opportunity to commit fraud. This can be done through a variety of means, including:

- Strengthening internal controls, including accounting and computer access controls. Particular attention needs to be paid to controls in the areas of tendering and procurement; and
- Monitoring, reviewing and updating internal controls – preferably in conjunction with external experts – on a periodic basis to prevent complacency.

3.5 A Detection Strategy

When fraud occurs the typical reaction of senior management includes shock, anger, denial and confusion. Although these are understandable responses, they tend to incite managers to act either prematurely or too slowly. Often fueled by their emotions, they lash out at the suspected fraudster or withdraw into a defensive, wait-and-see shell.

Neither strategy works. By angrily confronting the person before they have solid information, they could tip their hand too soon. And in doing so, they could open themselves up to a wrongful or constructive dismissal suit. By waiting too long – or not acting at

all – they could endure further losses. Or give the fraudster time to destroy essential evidence and cover up the trail.

What's preferable is to have a detailed, orderly system that spots fraud warning signs as early as possible and promptly responds to them in an appropriate, organized manner. This system allows a firm to respond to the possibility of fraud in a fair, objective and discreet fashion.

Moreover, by having such a system, you avoid having a situation in which the rewards of committing a fraud outweigh the risk of detection and, by extension, of punishment. Increasing the risk of being caught – as well as ensuring that perpetrators are severely dealt with – plays an important role in fraud prevention.

In addition, the business or agency in question needs to be prepared to deal severely with the perpetrators through appropriate internal sanctions and, where warranted, by taking the matter to the police.

The first decision is who to involve. Should the company call the police? Retain legal counsel? Engage independent forensic accountants?

The answer depends on numerous factors, from the circumstances of the fraud itself to who is involved and the outcome the company wants to achieve. Suffice it to say that professional input and advice are critical to finding the best possible solution.

As soon as the company becomes aware that fraud may be happening it should have two primary initiatives:

- 1) To take appropriate steps to stop the fraud from continuing;
and
- 2) To secure all documentation and other relevant information.

At the same time, management should endeavor to keep an open mind concerning guilt or innocence. Allegations, poison pen letters, circumstantial evidence or suspicious behavior do not necessarily mean a person has committed a fraudulent act. For the sake of the individual under suspicion, the morale of the company and to avoid litigation, the company must not jump to conclusions that are wrong or that cannot be proved.

4.0 Conclusion

Protecting the bottom line from fraud is a challenging goal. But it can be achieved through the implementation of an effective prevention and detection strategy.

What are the elements of such a strategy?

- Understanding why fraud is committed;
- Ensuring that factors that may motivate employees to commit fraud are minimized;
- Understanding the opportunities for fraud in the business or agency in question;
- Pinpointing the exposures and high risk areas;
- Reducing the opportunities for fraud;
- Knowing the symptoms of fraud;
- Establishing, monitoring and updating control procedures to look for symptoms;
- Being alert for symptoms; and
- Acting in an appropriate manner to resolve the identified problems, including seeking out the appropriate sanctions against the perpetrators.

Through such a strategy, a business, government agency or individual can protect the bottom line by nipping a potential fraud in the bud, or, at the very least, stopping it in its tracks before it runs its full course.