

Forensic Accounting Fundamentals

How forensic accountants can help prevent – and detect – fraud in your company.

By George N. Saliba, Managing Editor

Technology can, on the one hand, facilitate occupational financial crimes, but, on the other hand, leave substantial digital evidence, making it potentially easier to catch criminals if they are a company's employee(s). Within this context, forensic accountants increasingly possess highly sophisticated computer-based tools designed to analyze digital evidence and all other components of a "business fraud equation." That said, more traditional, manual-sleuth methods remain valid.

According to a recent survey by The Association of Certified Fraud Examiners (ACFE), "Asset misappropriation was, by far, the most common form of occupational fraud, occurring in more than 83 percent of cases, but causing the smallest median loss of \$125,000. Financial statement fraud was on the other end of the spectrum, occurring in less than 10 percent of cases, but causing a median loss of \$975,000. Corruption cases fell in the middle, with 35.4 percent of cases and a median loss of \$200,000."

Business leaders will do well to learn about forensic accountants' capabilities, and whether or not they should hire one.

The Computer Evolution

Hubert Klein, partner in the forensic, litigation and valuation services group at Eisner-Amper LLP, describes a breathtaking technological shift regarding the software tools

he implements. He recalls, "We [used] to say [years ago]: 'This is what the computer says. Somebody do a manual check to make sure the computer is right.' Today, we use the computer to make sure that the stuff we do manually is correct; it is the reverse."

Klein rattles off a laundry list of cutting-edge, brand-name forensic accounting software programs used to uncover illicit activity. Yet, such programs are not always limited to financial aspects.

He explains, "When you gathered evidence in the past, you would basically have numbers and supporting evidence. But, today, sometimes you corroborate that activity with e-mails, text and instant messages. We find that human beings are creatures of habit, and when they do things when they are working with others, they avoid – for some reason – direct conversation on the phone or in person, and communicate through e-mail, text and instant messaging."

Of note, from a computer forensics standpoint, so-called "deleted data" is not actually deleted when users believe they have done so; it can be recovered and restored by experts hired to do just that.

Eric Kreuter, partner at the accounting firm of Marks Paneth, echoes the thoughts of others: "People are not careful, because they don't think somebody down the road is going to be looking at what they write, or they think that it might not be able to be interpreted. What we do is key word searches, in data. We are looking for patterns of activity, regarding people. For example, are there excessive transactions in a certain part of the world? Are there transactions of a certain nature, regarding a person? Is he/she moving money on a regular basis?"

As Andrew M. Baxter, senior manager at WeiserMazars, LLP, in Edison, generally concurs, "We will go into



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clients' systems, and we'll collect gigabytes of data from their general ledgers, their time and expense systems – any of the systems that the person (suspect) touched. We look for patterns, and what we basically say is: 'You follow the money; trace the funds.' Technology certainly has allowed us to do that very quickly, and to process and handle huge amounts of data, looking for trends."

Sometimes an individual employee within a company may be highlighted

for scrutiny, or perhaps a group of individuals, but – in any case – forensic accountants address, in part: What are the expenses being created as a result of the suspected fraud activity?

Analog Methods

Technology can be a savior in many ways, but traditional forensic accounting methods still have validity. In the case of a car wash operation where an employee could be suspected of embezzling funds, one forensic accountant told *New Jersey Business* that many methods might be employed to "prove" the case, including, but not limited to: manually counting the number of cars entering and exiting the car wash; determining how many times the cash wash "recycled" its water via a reclamation tank; and quantifying the amount of supplies ordered for the car wash. These calculations could all reveal how many cars actually used the car wash, and – if revenue did not align with that figure – help prove an embezzlement case.

Separately, if someone cannot account for purchases in their life, and a valid gift/inheritance cannot be verified, it is possible that they have stolen money.

Therefore, especially for many cash-centric businesses, the IRS – as well as forensic accountants – will examine whether or not a person's home is mortgaged, and, if the home is paid for, from where that money originated. Moreover, any boats, jet skis or all-terrain vehicles must have been somehow been paid for, and a forensic accountant may want to determine their source monies. Even insurance policies can reveal purchases such as expensive artwork that might otherwise remain undetected. From where did the person obtain monies for the artwork listed as insured?

While one forensic accountant detailed the ease of imaging (copying) the contents of a computer hard

drive without the computer even being turned on, old-fashioned "detective work" is not at all obsolete.

A Company's Size and Location

Also at play in forensic accounting is the number of locations a business has – and its size. For a small business with one location, it may be easier to identify an ill-intentioned bookkeeper than it might be to locate a criminal in a multi-national corporation.

Baxter explains that a key is knowing who is the custodian of certain data, anywhere in the world. Within the context of global operations, he adds, "Then, the other piece is being familiar with local data privacy laws. That can be very, very important. For example, we are dealing with the following, with a client: France has very strict privacy

data laws. You cannot just go and grab an e-mail server, and take a forensic image and start running searches."

Proper Internal Controls

Sean Raquet, partner at Bederson LLP and president of the New Jersey Chapter of the Association of Certified Fraud Examiners, worked on one case in which a controller had check-signing authority with: access to the company's online banking system; responsibility for reconciling the bank account; and that person also posted to the financial reporting system. Raquet explains, "There was no segregation of duties. Proper internal controls require segregation of duties, so that if I am reconciling to the bank account, [there is another person] who cuts the checks."

Accountants indicate that much grief can be avoided by having correct internal controls. In fact, one forensic accountant indicated that, as a preventive measure, a billion-dollar-revenue client of his, still has its vice presidents sign each and every check.

Key Indicators

What can businesses be on the lookout for, regarding occupational fraud? Michael A. Skrief, principal – forensic services, PricewaterhouseCoopers, says, "If I was monitoring activities to see if there was a risk indicator of fraud, I would look for: unexplained variances between budget and actual amounts; or, financial activity that does not align with the average. So, let's say I was in the energy, oil and gas industry, right now, and a number of industry com-

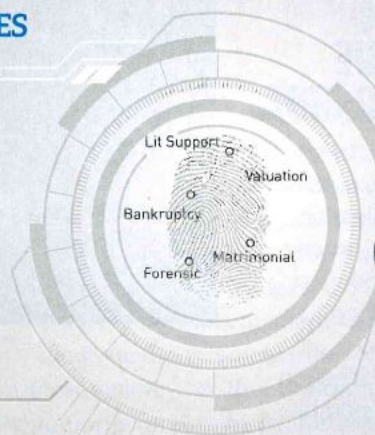
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petitors were having below-average earnings; they had write-offs, and my company earnings are still on the up-tick. I haven't had any write-offs, in terms of my assets. Well, what's going on? Why don't I follow the industry

average at this time, especially within the markets? I would look for an area where I know there are already decreased internal controls, or a lack of segregation duties, and that could be because I have decentralized opera-

tions. Do I have subsidiaries that are operating autonomously? I would look for those types of situations, and monitor those, to ensure there is no potential fraud activity, because it is the lack of internal controls that is a key indicator that there may be a fraud that could occur. It is just ripe for that situation."

Skrief adds that other indicators include: abnormal changes in account balances, increased expenses, or any unusual transactions in terms of amounts and timing (numerous transactions that are recorded after the end of the day or on holidays, for instance).

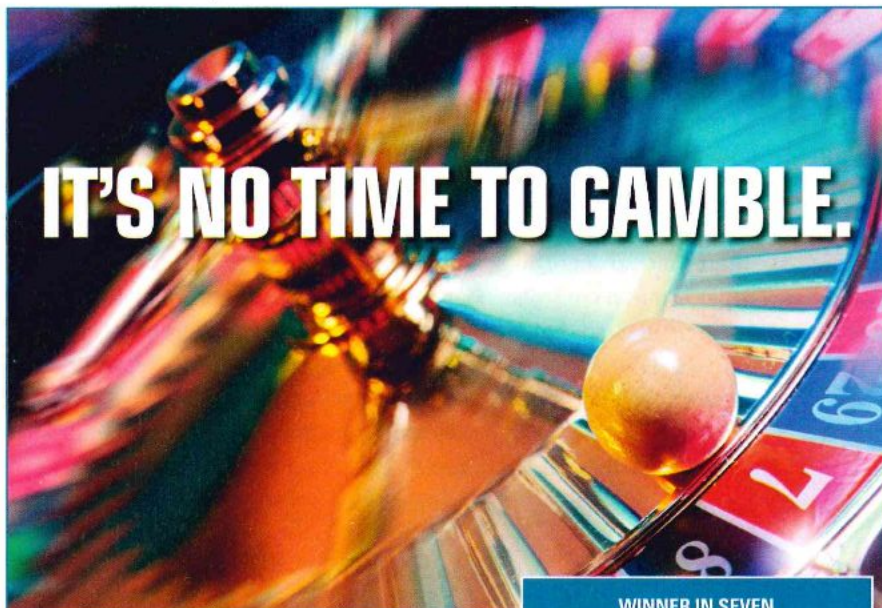
Reaching Out for Assistance

For a business owner who suspects fraud is occurring at his or her place of business, contacting an attorney or forensic accountant can be a first step. Logistical iterations exist: Sometimes an attorney is contacted first to determine the appropriate, best way to hire a forensic accountant. Also, many forensic accountants indicate that law enforcement is often not contacted, because businesses don't necessarily want their fraud cases becoming public knowledge for customers and/or clients to learn about.

Conclusion

Fraudsters don't expect to be caught, so business owners who are alert to embezzlement or other crimes, might be the exception rather than the rule. If business owners are in doubt, forensic accountants can help reveal if there is a problem.

EisnerAmper's Klein concludes, "Small businesses tend to be comfortable with long-time employees, and people who are basically unrelated family, and by that I mean they have been there so long. They work together; they spend one third of their day, five days a week, for most of their lives, with that person, and they trust them implicitly. And, sometimes, good people do bad things." **NJB**



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