Forensic Accounting and Fraud Investigation

IIA Atlanta Chapter / Governmental & Not-for-Profit
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Course Overview and Objectives

Background / Overview / Context

- Skill Sets and Background for Fraud Investigation and Forensic Accounting
- Financial / Operational Processes
- Fraud Schemes
- Investigation Methodology
Course Overview and Objectives

Theoretical Concepts and Framework
- Forensic Data Preservation and Collection
- Types of Data for Analysis: Qualitative and Quantitative
- Data Analysis Tools and Sources
- Data Analysis Queries
Course Overview and Objectives

Practical Applications and Case Examples

- Payments to Suspicious Vendors
- Payroll Fraud and Abuse
- Top Current Red Flags (from a recent case): Capital Projects / Construction, Contracts and Procurement
Skill Sets and Background for Fraud Investigation & Forensic Accounting
The Forensic Accountant: Skill Sets

Knowledge and Experience in:

- Financial Statements and Audit
- Internal Controls and Operational Processes
- Fraud Schemes
- Investigation and Legal Elements of Fraud
- Psychology of the White-Collar Criminal
Financial / Operational Processes
Typical Financial / Operational Processes

- Financial Reporting, General Ledger, Analysis, Reconciliation
- Capital Projects, Fixed Assets
- Payroll, Human Resources
- Purchasing, Receiving, Payables
- Production, Inventory
- Revenue, Shipping, Receivables
Fraud Schemes
External Fraud

- Theft of Data, Intellectual Property
- Identity Theft
- Financial Institution Fraud
- Payment Fraud
- Insurance Fraud
- Healthcare Fraud
- Consumer Fraud
- Cyber Fraud / Cybercrime
- Contract and Procurement Fraud
- Bankruptcy / Insolvency Fraud
- Securities Fraud
- Money Laundering
- Tax Fraud
Internal Fraud

- Fraudulent Statements
- Asset Misappropriation
- Corruption
Internal Fraud

Internal / Occupational Fraud

- Fraudulent Statements
- Asset Misappropriation
- Corruption

- Financial
- Non-Financial
- Cash
- Inventory & All Other Assets
- Conflicts of Interest
- Bribery / Kickbacks
- Illegal Gratuities
- Economic Extortion

Economic Extortion
‘Traffic Signals’

- Perpetration, Schemes and Risks
- Detection, Symptoms and Red Flags
- Prevention, Controls and Countermeasures
Investigation Methodology:
From Investigation to Prosecution
Rocks, Puzzles and Skeletons

Rocks

The Puzzle

- Pieces
- Pictures on Boxes

The Skeleton

Bones = Data Analysis

Muscles = Documentation

Organs, Cardiovascular = Witnesses, Interviews

Skin = Reporting
Forensic Data Analysis:
The Skeleton
The Process of Data Forensics and Analysis

- Collection / Preservation
- Conversion / Reconstruction
- Qualitative
- Quantitative
- Analysis of Data
Types of Data for Analysis: Qualitative and Quantitative
Quantitative Data: Financial Analysis

Data Files and Fields
- Vendor / Supplier Master File
- Employee Master File
- Invoice Listing
- Check / Payment Listing (Payables, Payroll)
- Expense Reimbursement Reports
Data Analysis Tools and Sources
Sources of Data: Financial

Quantitative / Financial
- Bank Statements
- Tax Returns
- Utility Bills
- Credit Reports
- Credit Card Statements
- Mortgage Statements
- IRA, 401(k) Accounts
- Brokerage Accounts

Qualitative / Lifestyle
- Real Estate Tax
- Property Tax
- Assessments
- Liens, Judgments
Qualitative Data: Background Checks

- Employers
- Criminal Records
- Addresses
- Driver’s License
- Professional Licenses / Affiliations
- Bankruptcy Records
- Liens / Judgments
- Property Deeds
- Foreclosures
- Assessments
- Evictions
- Vehicle Information
- Global Watch Lists
- U.S. Business / Corporate Affiliations
- UCC Filings
- Aircraft Records
- Pilot Licenses
- Voter Registrations
- Hunting Permits
- Weapon Permits
- Relatives
- Neighbors
Data Analysis Aggregators and Software (Tools)

Quantitative / Query
- ACL
- IDEA
- ActiveData
- ScanWriter
- MS Access
- MS Excel

Qualitative / Background
- TLOxp
- Tracers
- DelvePoint
- CLEAR
Putting Theory into Practice: Case Examples and Applications
Suspicious Vendors
Payment Stratification

>$500K: 10 Vendors, 1,000 invoices, $20 million

$100K - $500K: 50 Vendors, 2,000 invoices, $10 million

$5K - $100K: 500 Vendors, 10,000 invoices, $10 million

< $5K: 2,000 Vendors, 8,000 invoices, $2 million
Suspicious Vendors

Vendor A (1 invoice, $35,000)
- Only documentation is proposal for motivational speaking
- No evidence of services provided
- Ties to known criminal activity

Vendor B (9 invoices, $154,192)
- 7 of 9 voucher packages missing from files
Suspicious Vendors

Vendor C (14 invoices, $627,942)
  o FY03 Contracts totaled only $206K

Vendor D (2 invoices, $73,066)
  o Building rent paid one year in advance
  o Rent amount appears excessive

Vendor E (28 invoices, $437,192)
  o No contract listed
  o Checks hand delivered to employees

NOTE:
Vendors C, D and E located at same physical address.
Suspicious Vendors

Vendor F (24 invoices, $219,575)
- Inadequate or altered documentation
- No invoice number or missing invoice number
- Invoices generated from 4 different addresses
- Unusual / complex billing & payment process
- Invoices prepared & approved by same person
Payroll Fraud
Payroll Fraud: Perpetration, Schemes and Risks

- Ghost Employees (or keeping former employees on the payroll)
- Overpayment Schemes (by Inflated Rates and / or Hours)
- Diverting Wages or Payroll Taxes (Theft of Withholding Taxes)
- Stealing Paychecks / Fraudulent Endorsement
Data Analysis: Payroll Statistics

In 2,110 different SSN’s paid in One Year ($45.8MM):

- 4 employees, 86.8 hrs Avg. / Wk ($225K)
- 5 employees, 75.0 hrs Avg. / Wk ($232K)
- 322 employees, 60.7 hrs Avg. / Wk ($11.2MM)
- 38 employees, 55.0 hrs Avg. / Wk ($1.5MM)
- 912 employees, 41.2 hrs Avg. / Wk ($28.6MM)
- 829 employees, 8.8 hrs Avg. / Wk ($3.9MM)
- 83 employees, 0.0 Total Hours Worked ($239K)
Payroll Case Example

- Same SSN, but Different Employee Number & Pay Rate

Example: Employee A

- Hours Worked: 4,123 in FY1, 4,078 in FY2
- Pay Rates: $9.50 and $20.15 (FY1) / 22.27 (FY2)
- At higher pay rate, 80 hours in every pay period
- Total Annual Comp: $63K (FY1), $67K (FY2)
In a Single Month…

By County A:
- Paid 94 hours Regular Time (Not Comp Time)
- Also paid for 98 hours Compensatory Time

By County B:
- Paid $10,000 at a rate of $500 per day
- Equates to 20 days or 160 hours

254 hours > 248 hours
(31 x 8, including weekends and one holiday)
In a Two-Week Period…

By County A:
- Paid 62.5 hours Regular Time (not Comp Time)
- Paid 17.5 hours Clock Time (not Comp Time)

By Vendor:
- Paid $7,500 for work during same week
- Documented by e-mail
- Not disclosed to County Commissioners
Analysis to Identify Red Flags
Data Queries and Analysis Concepts

- Pre-defined queries designed to identify symptoms and indicators of possible fraud (‘Red Flags’)
- Trend / Fluctuation (Vertical / Horizontal) Analysis
- Payment Stratification
- Inconsistent Dates
- Payroll – Hours, Rates, Pay Types
- Consulting Services, P.O. Boxes, Initials
- Reconstruction of Bid Packages
- Reconstruction of Payment Request / Payment Application Packages
- Benford’s Law
Typical Queries for Identification of Red Flags

1. Vendors: New, Inactive, Cancelled
2. Employees: New, Inactive, Cancelled
3. Vendor / Employee Address Match
4. Invoice: Same Invoice / Same Amount / Same Vendor
5. Invoice: Same Invoice / Same Amount / Different Vendor
6. Expense Reimbursements
7. Rounded Dollar Amounts
8. Payments made on Holidays
9. Payments made on Weekends
Top Current Red Flags (from one recent case)

1. Changes in ratings of bidders
2. Slow payment → Fewer bidders → Same bidders → Higher Prices
3. Contractors meeting with government leaders (e.g., commissioners)
4. Work performed, but not in contract (Out of Scope)
5. Work in contract, but not performed (‘Padding’ or ‘Cushion’)
6. Vendor evaluations that are consistently below average (Poor quality work)
   - 19 Evaluations: 5.89 (Sep 2014 – Dec 2020)
   - 21 Evaluations: 3.00 (Oct 2016 – Jul 2021)
   - 16 Evaluations: 4.75 (Dec 2015 – Jul 2021)
7. General, repetitive, minimal descriptions of work performed
Top Current Red Flags (from one recent case)

8. Culture: Lack of in-house expertise / ‘Not my job’ / ‘Turn a blind eye / deaf ear’
9. Contractors functioning as Full-Time Employees (FTE / 40 hrs. / week for months and years, at 4x pay multiple)
10. Change Orders prepared after work performed
11. Change Orders more than 50% of the original contract
12. No line-item reconciliation of actual spending to budget / contract
13. Chronic over-spending of budgets and contracts
14. Chronic, Extended Missed Deadlines and Requirements
15. Ineffective work, in achieving objectives
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Red Flags Identified by Data Analysis

1. Award to other than lowest (or best rated) bidder
2. Different specifications than prescribed in RFP
3. Unusual matches (Vendors at same address, multiple SSN’s, etc.)
4. Failed tests or inspections
5. Too few bidders
6. High / excessive prices, compare with market, P.O. or other vendors
7. High volume purchases, compared with history or need
8. Improper change orders
9. Late delivery / missed deadlines
10. Low bid award → change order
Red Flags Identified by Data Analysis

11. Low quality products or services
12. Bidder data (late bidder is winning bidder, winning bid is just lower than 2\textsuperscript{nd} lowest)
13. Pattern or qualified or previous bidders not bidding, same bidder wins large majority of contracts
14. Missing inventory (received, but not used; invoiced but not received; returns with no related credits)
15. Multiple payments in same / similar amounts
16. Multiple purchases under bid limits
17. No purchase order or contract
18. No receiving report
19. Payment without invoice
Red Flags Identified by Data Analysis

21. Price discrepancies
22. Qualified contractors fail to bid
23. Questionable invoices
24. Questionable purchases
25. Purchases of consumer items (identified with SIC codes)
26. Questionable sole-source awards / contracts
27. Sequential invoices
28. Small initial purchase, followed by much larger purchase(s)
29. Unknown bidder(s) or vendor(s)
30. Unusual approval pattern(s)
31. Unusual bid pattern(s)
32. Line-item bids too low