

SIGNS OF FRAUD: DISCOVERY

By *Neil H. Fishman*

What is the first thing you should do when a fraud is discovered? The most important thing may be what you don't do first. Do not shout out that a fraud may have been committed. Keep the discovery or suspicion as quiet as possible. While the identity of a perpetrator and the full extent of a fraud remain unknown, it is best to keep an investigation small and quiet. The more people that know an investigation is under way, the more likely that the perpetrators will find out and cover their tracks.

When to Suspect

There is a wide range of events that warrant suspicion of a fraud, including the following:

- Employees being secretive about their work and responsibilities
- Employees that appear to be living beyond their means
- Checks clearing for unusually large amounts
- Checks clearing on long-dormant payables
- Numerous invoices from the same vendor
- Invoices without proper supporting documentation.

When one or more of these symptoms appear, the most important response is to keep it quiet. At first, all one has is the suspicion of impropriety. Valid, legally obtained evidence is required before any personal accusations can be made. According to Black's Law Dictionary, evidence is defined as:

Anything perceivable by the five senses, and any proof, such as testimony of witnesses, records, documents, facts, data, or tangible objects legally presented at trial to prove a contention and induce a belief in the minds of a jury.

Evidence must be material and relevant. Relevant evidence must address motive, opportunity, means, ability, physical evidence, or an attempt to destroy or conceal evidence. Whenever a fraud investi-

gation is performed, it must be done under the presumption that it will eventually go to court.

The second reason for maintaining silence on an investigation is to prevent suspects from knowing about the investigation. If the responsible parties find out, they will in all likelihood cover their tracks, lay low until after the investigation is completed, and start again when they feel that it is safe.

Example. An internal troubleshooter was in charge of auditing payments to suppliers, reviewing the supporting documents, and mailing the checks. Every so often, she would purposely fail to mail a check to a vendor. The vendor would eventually call about the late payment. They would be told that the invoice was paid on a certain date. Accounts payable would contact the troubleshooter to research the problem because they did not have a copy of the cancelled check (which was being held by the troubleshooter who had stolen it). The troubleshooter would tell accounts payable to issue a replacement check while she put a stop payment on the first check. The vendor received his payment, and the troubleshooter, instead of stopping payment on the first check, deposited it into her own account. (Joseph T. Wells, *Occupational Fraud and Abuse*, Obsidian, 1997)

Any investigation starts with company records. Evidence must be found within company records. A business owner needs a valid reason to hire a private detective to investigate an employee. The purchase of a new car or expensive jewelry is insufficient by itself to overcome an employee's right to privacy.

Accusations made without corroboration could be considered slander or defamation, especially if they are made to others or in the presence of others.

Example. An anonymous tip asserts that the paymaster is stealing cash from the company. He has been seen driving a new BMW and has taken expensive vacations. Although he has been a long-time, trusted employee, a fraud examination is performed. While there are several ways to conduct an investigation, the fraud examiner first compares total salary expense for the current year with last year's.

This year's balance for salary is \$220,000, a significant increase over last

year's expense of \$180,000. The owner reports that no new employees have been added and that all employees, owner included, received a 10% raise. This increase means that salary expense should be approximately \$198,000. The fraud examiner therefore believes that excess salaries went to someone.

The next step is to follow the salary expense overstatement backwards from the income statement through the accounts and journal entries to the source documents; in this case, the payroll checks. Several checks are found payable to an employee who left early the previous year. The endorsements on these checks are distinctly similar to those of the paymaster. Armed with this evidence, the investigator interviews the paymaster, who confesses to stealing \$22,000 and concealing the theft by issuing payroll checks to a nonexistent employee, checks which he subsequently endorsed and cashed.

When to Make an Accusation

Any and all accusations of fraud, malfeasance, or embezzlement should never be made until an investigation has been completed. Such an investigation, undertaken with great care and diligence, should at least determine who might be responsible of impropriety. Once suspects have been identified, consult with legal counsel about investigatory methods before initiating an investigation outside of the workplace.

When the time comes to speak with an individual, it should be done privately, one-on-one. Never make an outright accusation at first, but rather bring the discrepancies to the suspect's attention and hear what they have to say. As they give their side of the story, bring the evidence to the suspect's attention. It is important that in such interviews the interviewer keep it from becoming too confrontational too soon. When interviewing suspected individuals, encourage their cooperation as much as possible. The information from the company records is just a means to finding an explanation of the circumstances or a confession of guilt. □

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