

Forensic Accounting – Fraud Investigations



Forensic & Valuation Services

Practice Aid

Forensic Accounting—Fraud Investigations

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Recent Development Significant to This Practice Aid: AICPA's Ethics Codification Project

The AICPA's Professional Ethics Executive Committee (PEEC) restructured and codified the AICPA Code of Professional Conduct (code) so that members and other users of the code can apply the rules and reach correct conclusions more easily and intuitively. This is referred to as the "Ethics Codification Project."

Although PEEC believes it was able to maintain the substance of the existing AICPA ethics standards through this process and limited substantive changes to certain specific areas that were in need of revision, the numeric citations and titles of interpretations have all changed. In addition, the ethics rulings are no longer in a question and answer format but rather, have been drafted as interpretations, incorporated into interpretations as examples, or deleted where deemed appropriate. Some examples are as follows:

- The "Independence Rule," *Independence* (AICPA, *Professional Standards*, ET sec. 101 par. .01), will be referred to as the "Independence Rule" [ET sec. 1.200.001] in the revised code.
- The content from the ethics ruling titled "Financial Services Company Client has Custody of a Member's Assets" (AICPA, *Professional Standards*, ET sec. 191 par. .081–.082), was incorporated into the "Brokerage and Other Accounts" interpretations [ET sec. 1.255.020] found under the subtopic "Depository, Brokerage, and Other Accounts" [ET sec. 1.255] of the "independence" topic [ET sec. 1.200].

The revised code is effective December 15, 2014, and is available at <http://pub.aicpa.org/codeofconduct>. The pre-revision code is available at www.aicpa.org/Research/Standards/CodeofConduct/Pages/default.aspx. Citations to the code in this manuscript are provided in footnotes for both the revised and the pre-revision code.

The PEEC has created a mapping document that can provide additional assistance in locating pre-revision content in the revised code. The mapping document is available in Excel format at www.aicpa.org/InterestAreas/ProfessionalEthics/Community/DownloadableDocuments/Mapping.xlsx and can also be found in appendix D in the revised code.

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Chapter 1

Introduction

The AICPA's Forensic and Litigation Services (FLS) Fraud Task Force revisited AICPA Practice Aid 07-1, *Forensic Accounting-Fraud Investigations* and Special Report *Forensic Procedures and Specialists: Useful Tools and Techniques* to combine these resources into a single, comprehensive practice aid. Revisions were made to accommodate changes in language, scope of coverage, and advancements in the legal, technological, and regulatory environments that have occurred since the introduction of these documents in 2007 and 2006, respectively.

This practice aid provides you, the forensic accountant, also referred to herein as practitioner, with a framework for understanding the scope of services, administrative considerations, and investigative techniques that are typically involved in forensic accounting engagements.

Scope of This Practice Aid

Cases involving management fraud, money laundering, tax fraud, bankruptcy fraud, securities fraud, and other types of fraud continue to be prevalent and are increasing in frequency. Fraud issues surface in many engagement circumstances that involve the skills of the practitioner, including attest, tax, and general consulting services. This practice aid discusses your responsibilities, opportunities, and assignments only in the context of forensic accounting services, which comprise litigation consulting and fraud investigative services, and provides you with non-authoritative guidance for engagements in which you are providing such services. This practice aid does not set standards for the performance of such engagements or other forensic accounting services.

A key difference between forensic accounting services engagements and other consulting services engagements is that forensic accounting services involve an existing or potential dispute resolution proceeding. Many CPA services that address or consider the possible occurrence or prevention of fraud are not necessarily classified as forensic accounting services. These services include the following:

- Assessing the risk of fraud and illegal acts
- Evaluating the adequacy of internal control systems
- Substantive testing of transactions during an attest or a general consulting engagement
- Designing and implementing internal control procedures
- Proactive monitoring and performing analysis and tests when fraud is not suspected
- Preparing company codes of business ethics and conduct
- Developing corporate compliance programs

These services are not addressed in this practice aid. You may perform many or all of these activities when providing either litigation or non-litigation services that involve concerns about fraud.

When you are providing non-litigation services, you may encounter signs of actual or potential fraud that may be considered within the existing non-litigation services engagement or be addressed specifically in a separate engagement. If an attest team detects errors or irregularities that suggest fraud, the attest engagement team must comply with the applicable professional standards. In doing so, the attest team should report their concerns to management or other company representatives who may, in turn, initiate a fraud investigation using appropriate counsel or a forensic accountant. Management could then provide the findings to the attest team, who would evaluate the findings of the investigation and proceed as appropriate. This practice aid discusses many fraud investigation assignments and approaches but does not suggest that all such services should be included in every practitioner's scope of practice.

Professional Standards and Non-authoritative Guidance

Readers should be aware that the following authoritative literature applies to forensic accounting services as well as any other non-attest service provided by practitioner in public practice:

- AICPA Code of Professional Conduct
- CS section 100, *Consulting Services: Definitions and Standards* (AICPA, *Professional Standards*)
- VS section 100, *Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset* (AICPA, *Professional Standards*), where applicable

CS section 100 applies to fraud investigations as forensic accounting services and subjects such engagements to the AICPA Code of Professional Conduct, which comprises the standards of professional competence, due professional care, planning and supervision, and sufficient relevant data. Additionally, CS section 100 establishes the standards of client interest, understanding with the client, and communication with the client.

In addition to this practice aid, other AICPA practice aids and special reports provide non-authoritative guidance about fraud investigations in forensic accounting services. These publications discuss the nature of forensic accounting services in more detail, including applicable professional standards, conflicts of interest, the differences among attest and consulting services, communication considerations for consulting engagements, and engagement letters.

Limitations of This Practice Aid

The guidance in this document is not a substitute for experience, professional judgment, or skepticism, but is meant to supplement your understanding of how and when these tools and techniques may be useful in obtaining additional evidence that would otherwise not be available during the course of an audit or other engagement. Forensic accounting and litigation consulting engagements often require the use of specialists who have specific training in areas such as data forensics, handwriting analysis, and private investigations. Because of the multi-disciplinary nature of these engagements, you should always be alert to situations where you are being asked by a client or counsel to perform a procedure or express an opinion that is outside of your practice area or competency. These situations present significant professional risks; engagement planning steps should include resource planning so that the necessary skill sets are appropriately provided and risks may be avoided. Technical consulting practice aids do not purport to include everything you need to know or do in order to undertake a specific type of service. Furthermore, engagement circumstances differ and therefore your professional judgment may cause you to conclude that an approach described in a particular practice aid is not applicable. This practice aid is de-

signed as educational and reference material for AICPA members and others who provide consulting services as defined in CS section 100.

Prevalence of Fraud

There is no denying that fraud has been and will most likely continue to be a prevalent reality for government and business, including owners, management, and other stakeholders. Numerous studies and statistics demonstrate the impact of fraud to businesses worldwide. These studies reflect the trends and types of fraud schemes, the profiles of perpetrators, and the means of discovery. Along with these data points are projections about the cost of fraud on a global basis. The shortcoming about many survey-based statistics is the leap required to extrapolate and quantify the losses. Many of the fraud studies are based on self-reported or publicly available information. There are countless instances of fraud that have been uncovered and reported privately without publication. There is no practical way to harness all of the relevant data elements into one unified study. The cost of fraud for a company that falls victim to a scheme is serious and can be significant. It is important for owners, management, and other stakeholders to be aware of potential fraud schemes and protect their organizations accordingly. A forensic accountant can be instrumental in both the prevention and investigation aspects related to fraud.

This practice aid is primarily designed to provide you with an overview of the stages along with the identification of resources and tools that may be employed in the execution of a fraud investigation.

Litigation Environment

A stricter regulatory environment and concerns about the economy have caused business owners, management, and stakeholders to take a close look at the litigation trends in the United States as well as overseas. As businesses in certain industries continue to grow, their risk of litigation also increases. Contracts, labor and employment, and personal injury litigation are cited as the three most numerous types of litigation seen by companies.^{fn 1}

Against this backdrop, practitioners are often called upon to provide a variety of services to assist the disputing parties and their respective counsel throughout the litigation process.

Elements of fraud allegations are often intermixed within other types of litigation matters such as bankruptcy, family law, business combinations, and economic damages. Although the primary focus of this document is the performance of a fraud investigation, many of the skills and tests employed for the practitioner could be beneficial in other forensic accounting consulting engagements. Chapter 3 provides an overview of the varied types of engagements that practitioners may face and the investigative techniques that may play a role.

One of the primary goals of a practitioner performing fraud investigations is the delivery of services that are in compliance with relevant legal, regulatory, and professional standards. As such, at the onset of each fraud investigation, it is important that you give careful consideration to building a team with diverse specializations and an understanding of the client-practitioner relationship.

^{fn 1} www.nortonrosefulbright.com/news/93066

Building a Team With Diverse Specializations

The nature and complexity of services requested of a practitioner in connection with a fraud investigation has increased, and will likely continue to increase, due to the ever increasing complexity of business in general. As such, practitioners often need to assemble multi-disciplinary teams of professionals with specialized knowledge, education, training, and experience so that the investigation is conducted effectively, efficiently, and competently. Although the exact makeup of any particular engagement team is dependent upon the individual needs of the engagement, in a forensic engagement, you may need to rely on other professionals with specializations in areas beyond your competency.

During the course of an investigation, you may leverage the services of a professional with experience in conducting investigative due diligence. Investigative due diligence activities often include analyzing publicly available information, searching proprietary databases, communicating with third parties, and conducting interviews. Some of the potential benefits of leveraging investigative due diligence services include the identification of the following:

- Criminal, civil, regulatory actions
- Financial distress
- Illegal, unethical business practices
- Related party transactions
- Undisclosed business interests
- Undisclosed liabilities

Other specializations may include computer forensic services and forensic data analysis services, as discussed in chapter 3 of this practice aid.

Client-Practitioner Relationship

At the beginning of an engagement, it is important to determine whether your client, per the engagement letter, is internal or outside counsel for entities or individuals that are subject to the investigation. If counsel is the client, your work may be protected from discovery by opposing parties as long as you are granted legal privilege by the engaging attorney as described below, and you do not share findings or provide opinions to parties that are not similarly granted such privilege with respect to your work. In most instances in which you are retained as a consultant by counsel to assist with its investigation, such work will be protected by privilege. However, if your client is not counsel representing the parties under investigation, then the attorney's work product privilege may not protect your work from discovery. No matter how you are engaged, you should maintain working paper files and communicate both internally and externally with the expectation that the working papers and the communications will be produced to opposing parties and their counsel. A waiver of the privilege, or a production of documents compelled by a regulatory body, many times causes an unanticipated disclosure.

Legal privilege may protect your work. Legal privilege applicable to practitioners typically falls into one of the following categories:

- *Attorney-client privilege.* The client's right to refuse to disclose, and to prevent any other person from disclosing, confidential communications between the client and the attorney.
- *Attorney work product privilege or doctrine.* Under this rule, anything prepared by, or at the direction of, an attorney in anticipation of litigation is protected from discovery or compelled disclosure. This includes, but is not limited to, notes, working papers, and memorandums.

It is important for you to discuss with the client's legal counsel the extent your work is protected by legal privilege because it may influence communications, both internal and external, and how the work is directed, documented, and disclosed. In instances where legal privilege will be or may be asserted, you should confirm communication and documentation protocols, and work product and written communications should be identified on their face as "privileged" to aid in identification and protection.

Legal Bases for Fraud Allegations and Related Services

Many of the laws, regulations, and rules of the federal government, state governments, and other governmental entities and regulatory bodies specify prohibitions, fines, and penalties for fraudulent activity. The intent is to protect the interests of the pertinent governmental entity and the public. Legal pleadings usually cite the germane law or regulation related to the purported wrongdoing. Examples of areas covered by laws or regulations with fraud provisions include, but are not limited to, the following:

- Antitrust
- Banking
- Bankruptcy
- Computer technology
- Environmental protection
- Financial statements
- Government contract procurement
- Health care
- Insurance
- Intellectual property
- Racketeer influenced and corrupt organizations
- Securities
- Tax

The legal and regulatory guidance for these fraud matters is not static; it continues to evolve. For example, the rapid pace of advances in computer technology continues to spawn new fraud opportunities and schemes, and the legislators and regulators attempt to respond as needed. Therefore, a definitive, un-

changing list of fraud-related laws, rules, regulations, and court decisions, along with associated forensic accounting fraud investigative services, cannot be prepared and presented in this practice aid. Instead, selected examples of specific legal bases for fraud allegations are provided in appendix B, and classes of general fraud schemes are summarized in chapter 9. If are approached to provide fraud investigation services in any of the listed areas or for similar matters, you might inquire about or research the current legal or regulatory guidance. Also, you should assess the engagement team's skills, experience, and training to deliver the requested assistance in a professional and competent manner.