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Frimette Kass-Shraibman

Associate Professor, Brooklyn College – CUNY

Vijay S. Sampath

Forensic and Litigation Consulting, FTI Consulting, Inc.



Forensic
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**by Frimette Kass-Shraibman
and Vijay S. Sampath**



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About the Authors

Frimette Kass-Shraibman, PhD, CPA, is an associate professor of accounting at Brooklyn College-CUNY. She is also the editor of the *Journal of the CPA Practitioner*, a publication of the National Conference of CPA Practitioners News and Views. She is also a member of their Board of Directors. She spent over 20 years in public practice accounting where she practiced tax, audit, and forensics. She is formerly director of education for the Foundation for Accounting Education and a professional development manager at the American Institute of Certified Public Accountants. She has been awarded several medals for national tai chi competition. She is a life-long resident of Brooklyn, New York.

Vijay S. Sampath, CPA, CFE, MBA, is a managing director in the forensic accounting and litigation consulting practice at FTI Consulting Inc. He has more than 22 years of experience providing forensic accounting, litigation consulting, financial statement auditing, and business consulting services. He specializes in complex financial investigations involving generally accepted accounting principles and generally accepted auditing standards matters. Vijay also manages Foreign Corrupt Practices Act investigations, post-closing purchase price disputes, and other litigation matters involving white collar crime, bankruptcy, and contract proceedings. He is an adjunct professor at the Rutgers Business School, where he teaches financial accounting courses.

The views expressed in this book are those of the authors and not necessarily those of FTI Consulting Inc.

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Contents at a Glance

<i>Introduction</i>	
<i>Part I: Investigating Forensic Accounting</i>	7
Chapter 1: Why the World Needs Forensic Accountants	9
Chapter 2: Steering Your Career toward Forensic Accounting.....	21
Chapter 3: Getting to Know the Most Common Fraud Schemes	33
Chapter 4: Forensic Accounting Minus the Fraud	51
<i>Part II: The Anatomy of Occupational Fraud</i>	67
Chapter 5: Cooked Books: Finding Financial Statement Fraud	69
Chapter 6: Investigating Inventory Fraud	83
Chapter 7: Examining Revenue Recognition Problems.....	93
Chapter 8: Studying Securities Fraud.....	107
<i>Part III: It's All in the Family: Fraud against Individuals</i>	119
Chapter 9: Divorce with a Side of Fraud	121
Chapter 10: Protecting Estates, Trusts, and the Elderly.....	133
Chapter 11: Recognizing Real Estate Fraud.....	143
<i>Part IV: Meeting Your Methods of Investigation</i>	157
Chapter 12: Walking through the Investigation Process	159
Chapter 13: Tracing the Flow of Money	171
Chapter 14: Going to the Source: Obtaining Records	183
Chapter 15: Tapping into Electronic Evidence	199
Chapter 16: Who Wants to Know? Reporting on Your Findings	213
Chapter 17: Preparing for Trial: Business Litigation	227
Chapter 18: Organizing Evidence and Serving as an Expert Witness.....	243
Chapter 19: Peeking Inside Federal Government Fraud Cases	255
<i>Part V: Preventing Occupational Fraud</i>	271
Chapter 20: Helping Small Businesses Prevent Fraud.....	273
Chapter 21: Assisting Larger Businesses with Fraud Prevention.....	289
Chapter 22: Keeping Employees Honest (and Happy).....	305
Chapter 23: Applying Technology to Fraud Prevention	315

<i>Part VI: The Part of Tens</i>	329
Chapter 24: Ten Entertaining Portrayals of Fraud.....	331
Chapter 25: Ten Fairly Common – and Unsuspected – Frauds	337
Chapter 26: Ten Truly Strange Fraud Stories.....	343
<i>Index</i>	353

Table of Contents

.....

<i>Introduction</i>	1
About This Book	2
Conventions Used in This Book	2
What You're Not to Read	2
Foolish Assumptions	3
How This Book Is Organized	3
Part I: Investigating Forensic Accounting	4
Part II: The Anatomy of Occupational Fraud	4
Part III: It's All in the Family: Fraud against Individuals	4
Part IV: Meeting Your Methods of Investigation	4
Part V: Preventing Occupational Fraud	5
Part VI: The Part of Tens	5
Icons Used in This Book	5
Where to Go from Here	6

Part I: Investigating Forensic Accounting..... **7**

Chapter 1: Why the World Needs Forensic Accountants	9
Accounting versus Auditing: Defining Our Terms	10
Working as an accountant	10
Working as an auditor	11
Adding "Forensic" to the Mix	12
Taking accounting and auditing to the courtroom	12
Getting special training and licenses — or not	13
Creating the Need for Forensic Accountants: Fraud	14
What is fraud, anyway?	14
Who commits fraud, and who are the victims?	15
Why does fraud occur?	17
The incidence of fraud	19
Identifying Potential Employers: Who Hires Forensic Accountants?	20
Chapter 2: Steering Your Career toward Forensic Accounting	21
Setting Yourself Apart from the Accounting Pack	21
Taking the right courses	22
Getting certified: The CFE and other certifications	25
Finding Work	28
Considering public sector options	28
Considering private sector options	29
Internal auditors: Preventing fraud before it can occur	31
Specializing in Finding Computer Crimes	31



Chapter 3: Getting to Know the Most Common Fraud Schemes 33

- Frauds Committed by Businesses 33
 - Preying on vulnerable populations 34
 - Picking investors' pockets 35
 - Doing business with bribes 35
 - Laundering money 36
 - Perpetrating construction fraud 37
 - Dealing in subprime and predatory lending 38
 - Taking advantage of employees 38
- Frauds Committed against Businesses 40
 - Employee theft 40
 - Vendor and customer fraud 40
 - Insurance fraud 41
- Bilking the Government 41
 - Tax fraud 41
 - Contract fraud 46
 - Medicare and Medicaid fraud 46
 - Social Security fraud 48
- Introducing the Ponzi Scheme 49

Chapter 4: Forensic Accounting Minus the Fraud 51

- Business Valuation: Estimating Value 52
 - Standards of value 53
 - Premise of value 53
 - Valuation approaches 54
- Investigating Intellectual Property 56
- Estimating Environmental Damages 56
- Examining Auditor Malpractice Complaints 57
 - Plaintiff strategies 58
 - Defense strategies 58
 - The forensic accountant's role 59
- Calculating Business Interruption Costs for Insurance Purposes 59
- Tallying Construction-Related Damages 61
- Focusing on Avoidance Actions in Bankruptcy 63
 - Fraudulent conveyance 63
 - Preferential payments 64
- Dealing in Divorce 65

Part II: The Anatomy of Occupational Fraud..... 67

Chapter 5: Cooked Books: Finding Financial Statement Fraud 69

- Reviewing the Basics of Financial Statements 70
 - The big three 70
 - Who uses financial statements, and how? 72
- Studying What Prompts Financial Statement Fraud 73

Spotting the Common Methods of Fraud 75
 Hidden liabilities 75
 Cookie jar reserves 76
 Off-balance sheet transactions..... 77
 Notes no one can comprehend 77
 Uncovering Financial Statement Fraud 78
 Comparative techniques 78
 Ratio analysis 79
 Beneish model 81
 Data mining 82

Chapter 6: Investigating Inventory Fraud 83

 Reviewing Inventory Basics 83
 Defining our terms 83
 Valuing inventory 84
 When is inventory an asset? 86
 The Motives and Means of Misrepresenting Inventory 87
 Pumping up the volume: Creating phony inventory 87
 Turning down the volume: Letting inventory walk away 89
 Preventing and Unearthing Inventory Fraud 90
 Observing inventory counts 90
 Limiting fraud with audit techniques 91

Chapter 7: Examining Revenue Recognition Problems 93

 Reviewing How to Account for Revenue 94
 Identifying Common Motives for Altering Revenue Statements 95
 Trying to evade taxes 95
 Knowing that every penny counts 95
 Making extra bucks 96
 Adhering to debt covenants 96
 Getting to Know Types of Revenue Fraud 96
 Fictitious sales 97
 Lapping 97
 Redating 98
 Side agreements 98
 Channel stuffing 99
 Bill and hold 100
 Multiple deliverables 100
 Round tripping 101
 Improperly keeping the books open 101
 Other revenue frauds 102
 Uncovering Revenue Recognition Problems 102
 Testing the cut-off dates 103
 Looking at related-party transactions 104
 Investigating and analyzing accounts receivable 105

Chapter 8: Studying Securities Fraud 107

Falsifying Information in Financial Statements.....	107
Lying to Auditors	109
Cheating Investors.....	110
Operating a boiler room.....	110
Manipulating penny stocks.....	110
Conducting insider trading.....	112
Front running.....	113
Day trading	114
Abusing the short-selling process	114
Offering the wrong investment advice.....	115
Rapid-fire stock orders.....	116
Churning stocks	116
Preventing Your Clients from Becoming Victims.....	117

***Part III: It's All in the Family: Fraud
against Individuals..... 119*****Chapter 9: Divorce with a Side of Fraud 121**

Searching for Hidden Assets	121
Locating assets given to family, friends, or holding companies.....	122
Banking on foreign accounts	124
Studying tax returns and other financial documents.....	124
Requesting a Business Valuation.....	126
Identifying Hidden Income	126
Starting with basic research.....	127
Taking a look at the new girlfriend (or boyfriend).....	128
Looking at business contracts	129
Keeping the IRS at Bay	129
Recognizing injured and innocent spouse issues.....	130
Identifying common tax considerations	132

Chapter 10: Protecting Estates, Trusts, and the Elderly 133

Becoming Prime Targets for Fraud	134
Spotting Some Common Scams	134
Preying on hearing loss over the telephone.....	135
Reading the meter to gain home access	135
Pressuring someone to buy life insurance	136
Promoting high-yield investment schemes	137
Cashing in a life insurance policy	137
Getting Grandma to change her will.....	138
Presenting a forged will or hiding the will.....	140
Stealing Uncle Joe's house.....	142

Chapter 11: Recognizing Real Estate Fraud	143
Helping Homeowners Fight Fraud	143
Stealing a home with a false deed.....	144
Stealing a home through mortgage fraud	145
Protecting your clients' homes	147
Focusing on Repair Schemes	150
Shielding homeowners from unnecessary and improperly done repairs.....	150
Mechanic's lien: Knowing what it is and how to avoid it.....	151
Keeping Commercial Leases Honest	152
The square footage scheme	152
The landlord as retail partner	153
Boosting Banks' Fraud Defenses.....	154
Spotting phony mortgage applications.....	154
Being wary of phony appraisals.....	155

Part IV: Meeting Your Methods of Investigation **157**

Chapter 12: Walking through the Investigation Process	159
Figuring Out Whether to Fully Investigate	160
Assembling an Investigative Team	161
Planning the Investigation.....	162
Finding your focus	163
Going global.....	163
Developing workplans	164
Gathering and Reviewing Evidence	165
Dealing with documents	165
Conducting interviews	166
Remedying the Outcome	170
Chapter 13: Tracing the Flow of Money	171
Identifying Potential Red Flags	172
Analyzing financial statement basics	172
Detecting earnings management.....	172
Looking Closely at Bank and Other Records	174
Reconciling bank statements routinely	174
Studying 1099 forms	176
Cruising through credit card statements	178
Gathering Witness Testimony.....	178
The angry girlfriend or boyfriend (or ex-husband or ex-wife).....	178
Neighbors.....	179
Disgruntled employees	179
Conducting a Lifestyle Analysis.....	180

Chapter 14: Going to the Source: Obtaining Records 183

Identifying Relationships and Assets: Background Investigations	184
Figuring out relationships.....	184
Focusing on assets.....	185
Locating Corporate and Business Records Online	185
Knowing the types of records available.....	186
Feeling the love for databases.....	187
Background Investigation Search Tips	192
Follow a logical searching order	192
Verify the information you already have.....	192
If at first you don't succeed	193
Peel back the layers.....	193
Avoiding Investigative Pitfalls.....	194
Double- and triple-sourcing your information	194
Going to the source	195
Using Internet searches (with caution)	197
Staying legal.....	197
Taking the Next Steps	198

Chapter 15: Tapping into Electronic Evidence 199

Defining Electronically Stored Information (ESI).....	200
Structured ESI.....	200
Unstructured ESI.....	201
Preserving ESI with Legal Holds	201
Working with backup tape systems and other archives	202
Preparing for ESI collection.....	203
Collecting Preserved ESI.....	204
Getting more details with physical collections.....	204
Working with logical collections.....	205
Branching out to network collections.....	206
Avoiding common mistakes when collecting e-mails.....	207
Processing Data to Simplify Your Review	208
Removing non-reviewable system files	208
Tossing out duplicate files and e-mails.....	208
Searching for keywords	209
Using advanced language analytics.....	209
Reviewing Documents, E-mails, and Other Data	210
Performing Complex Data Analysis.....	210
Identifying ESI on the Web	211

Chapter 16: Who Wants to Know? Reporting on Your Findings. . . . 213

Determining Your Audience.....	213
Organizing Your Work Papers	214
Documenting Interviews	215
Creating a Masterpiece	216
Getting Familiar with Investigation Reports	217



Crafting Expert Reports 218
 Following the Federal Rules of Evidence 220
 Facing a Daubert motion..... 221
 Following the report template..... 221
 Preparing Oral Reports with Care 222
 Crafting Advocacy Reports 224
 Rendering Decisions in Arbitrations 224

Chapter 17: Preparing for Trial: Business Litigation 227

Where Do Fraud Lawsuits Come From?..... 228
 U.S. Securities and Exchange Commission (SEC) 228
 Public Company Accounting Oversight Board (PCAOB)..... 228
 U.S. Department of Justice (DOJ)..... 229
 State attorneys general 229
 Whistleblowers/plaintiffs..... 229
 Other watchdogs..... 230
 Looking at the Litigation Process 230
 Pleadings..... 231
 Discovery 231
 Trial 232
 Outcome..... 233
 Appeal 233
 Knowing the Standards of Proof..... 234
 Getting the Forensic Accountant Involved in Litigation..... 234
 Serving as a litigation consultant..... 235
 Taking the stand as an expert witness..... 236
 Being appointed a trier of fact 238
 Providing a Variety of Services 238
 Assisting with discovery 238
 Managing documents and data 238
 Developing case strategy 239
 Gathering intelligence 239
 Calculating damages..... 239
 Taking Care of Business..... 241
 Getting paid 242
 Understanding the work product privilege 242
 Protecting your work papers 242

Chapter 18: Organizing Evidence and Serving as an Expert Witness 243

Are You an Expert Witness or a Fact Witness?..... 244
 Knowing What Is Expected from an Expert..... 244
 Steering clear of failure 245
 Choosing your methodology carefully..... 245
 Aiming for success..... 246
 Presenting Your Credentials: Preparing Your CV 247
 Preparing Your Files..... 248

Giving Live Testimony	249
Getting the jury to listen	249
Surviving cross-examination	250
Knowing what to say, what not to say, and when to shut up	251
Mastering your body language.....	252
Preparing for an examination before trial (EBT)	253
Dressing for court or a deposition	254
Creating Visual Testimony	254

Chapter 19: Peeking Inside Federal Government Fraud Cases 255

Understanding Some Basics of Federal Law	256
Proving the elements of a crime	256
Realizing how federal financial crimes differ from others.....	257
Fighting Fraud in the Government Sector: The Enforcers.....	258
The U.S. Department of Justice.....	258
The Internal Revenue Service.....	259
Securities and Exchange Commission.....	260
Federal Bureau of Investigation	261
Using RICO Laws to Prosecute Fraud	265
Walking through a Federal Criminal Case	265
What to Do If a Government Agency Knocks on Your Door	269

***Part V: Preventing Occupational Fraud* 271**

Chapter 20: Helping Small Businesses Prevent Fraud 273

Refresher: Defining Internal Controls	273
Scouting for Signs of Fraud in a Small Business	274
Spotting inventory issues	274
Keeping a close eye on cash.....	278
Establishing Effective Internal Controls	280
Segregating duties.....	280
Handling hiring issues	281
Knowing who has the keys	282
Controlling who signs the checks.....	283
Limiting access to electronic systems	284
Taking Action after a Small Business Gets Ripped Off.....	286
Weighing costs and benefits: To prosecute or not.....	286
Determining the company's weaknesses.....	287

Chapter 21: Assisting Larger Businesses with Fraud Prevention 289

Conducting a Fraud Risk Assessment	290
Meeting the key players	290
Becoming familiar with corporate culture	292
Knowing the nature of the industry	294

Assessing and Strengthening Internal Controls	296
Performing an internal control assessment	296
Improving internal controls.....	299
Taking Action after a Larger Business Gets Ripped Off.....	301
Launching fraud investigations.....	302
Conducting surprise audits	302
Rotating jobs and requiring vacations	302
Setting up an internal audit department.....	303
Establishing a code of conduct	303
Training employees	304

Chapter 22: Keeping Employees Honest (And Happy) 305

Identifying Common Causes of Employee Theft.....	306
“They owe it to me”	306
“I’m just borrowing it”	307
“I need it more than they do”	307
Opportunity: Weak controls and the thrill of theft	308
How Do Employees Steal?	308
Setting the Right Tone from the Top	310
Connecting management fraud and employee fraud	311
Responding to employee fraud when it’s found	311
Using the tone from the top to boost business	312
Gauging Employee Satisfaction (Or Lack Thereof)	312
Doing some informal testing.....	313
Testing more formally for employee satisfaction.....	313
Using psychological tools to turn things around	314

Chapter 23: Applying Technology to Fraud Prevention 315

What Is Information Security?.....	316
Managing Information Risks.....	317
Securing IT Resources and the Network	317
Creating a strong IT department.....	318
Making the case for passwords.....	318
Encrypting data.....	319
Setting up firewalls	320
Guarding against spyware	320
Avoiding viruses and worms	320
Protecting a Company from Social Engineering	321
Spotting and preventing social engineering.....	321
Avoiding phishing attacks	322
Identifying Common Electronic Scams	323
Old-fashioned e-mail schemes.....	324
Trojan horse e-mails.....	324
Reacting smartly	325
Putting Technology to Good Use.....	326

Part VI: The Part of Tens 329**Chapter 24: Ten Entertaining Portrayals of Fraud. 331**

The Fly on the Wall.....	331
The Big Shakedown	332
The Sting.....	332
Trading Places	333
Wall Street	333
Working Girl	333
Quiz Show	334
Fargo.....	334
Telling Lies in America.....	335
Enron: The Smartest Guys in the Room.....	335

Chapter 25: Ten Fairly Common – and Unsuspected – Frauds 337

Doctoring a Résumé	337
Selling Art That Is Not Authentic	338
Using Spreadsheets Fraudulently.....	338
Selling Counterfeit Tickets	339
Staging Accidents to Bilk Insurance Companies	340
Inflating Tax Refunds.....	340
Committing Credit/Debit Card Fraud.....	341
Perpetrating Adoption Subsidy Schemes.....	341
Creating Fake Bank Confirmations	342
Carrying Out Commodity Fraud	342

Chapter 26: Ten Truly Strange Fraud Stories. 343

The Paper Behind the Wallpaper	343
Winning in Las Vegas . . . or Not	344
It’s Curtains for the Thief.....	345
Rolling the Car Downhill	346
Scraps for Sale.....	346
Cleanup in Aisle 3, Please!.....	347
Let’s Count What’s in the Piggy Bank	348
Baby, It’s Cold Outside!.....	349
The Answer Is Blowing in the Wind	350
“Grand” Theft	351

Index 353

Introduction

So, what exactly is forensic accounting? If you're signed up to take a course on the subject or are considering where you'd like your accounting career to take you, you may be reading this page because you're looking for clarity about what the field of forensic accounting entails.

The word *forensic* usually inspires visions of *Law and Order* or *CSI* scenarios: a crime was committed, and detectives are gathering forensic evidence to try and figure out the cause and manner of death. But *accounting* inspires visions of debits, credits, and financial statements. How could these two words possibly fit together?

When you realize that *forensic* means applying scientific knowledge to legal issues, the phrase becomes easier to figure out. *Forensic accounting* is the study and interpretation of accounting evidence for presentation in a legal forum.

Most of the time, forensic accounting is used when someone commits fraud. For this reason, forensic accountants are often referred to as *fraud investigators* or *fraud examiners*. Fraud takes many forms, but at its heart, fraud is theft. Fraud is profiting by deceit or trickery; it involves the theft of funds or information or the use of someone's assets without permission. Many fraud cases are small, but some are downright catastrophic, which is why names such as Enron and Bernie Madoff are now part of our cultural literacy. The latest statistics show that \$2.9 trillion (trillion with a *t*) is lost every year due to fraud, so as a forensic accountant, you have the chance to be a bit of a superhero — at least to the stockholders and employees whose life savings may be preserved if you can nip a business fraud in the bud.

Not every forensic accounting engagement centers around fraud. Forensic accountants are also involved in commercial litigation, calculating damages that can literally run into the billions of dollars. (BP oil spill, anybody?)

And forensic accountants don't always work on cases involving businesses. Sometimes, they're hired to search for hidden assets during a divorce, to help a homeowner whose property has been stolen with the stroke of a fraudulent signature, or to protect the estate of an elderly person who's been targeted by someone looking to make a quick fortune.

As we show you, the field of forensic accounting is new and growing explosively. If you think it may be the right path for you, we hope to help you better understand how exciting and challenging it can be.

About This Book

Most books about forensic accounting focus on one or two aspects of the field. This book is different — we wanted to give you a taste of every aspect of forensic accounting in a single book. We don't provide as much detail about each aspect as a forensic accounting textbook might (we can hear you shouting for joy!), but that's because our goal is different than a textbook's goal. First, we want you to actually understand what you read! Second, we want you to walk away from each chapter understanding why that subject matters — how the information comes into play when you're actually on the job.

We organized this book so that you can open up any chapter and start reading. If you're looking for something in a jiffy — whether it's information about inventory fraud or applying technology to prevent fraud — you can put your finger on it easily and read just that chapter or section without feeling lost.

We're also big believers in the importance of rooting academic discussions in real life. For that reason, we provide lots of stories in this book about real fraudsters and their get-rich schemes (which often result in them getting arrested and getting imprisoned).

Conventions Used in This Book

This isn't a book about financial accounting, so you don't have to memorize loads of picky conventions. Just keep a couple things in mind as you read:

- ✓ When we introduce a term that we think may be new to you, we put that word in italic and then define it for you.
- ✓ When this book was printed, some Web addresses may have needed to break across two lines of text. If that happened, rest assured that we haven't put in any extra characters (such as hyphens) to indicate the break. When using one of these Web addresses, just type in exactly what you see in this book, pretending as though the line break doesn't exist.

What You're Not to Read

We spent a lot of time creating this book, so we'd really like to believe that you're going to savor every word! But we're not that naïve. So here's the scoop: If you're in a rush and need to focus on the true nitty gritty, feel free to skip past the *sidebars* in this book: the gray boxes that are set apart from

the rest of the text. (See how this whole italic/definition thing works?) We've included some really juicy stories in some of those sidebars, but they are truly asides. If time is short, read around them and know that you're not missing any information that is crucial to your forensic accounting education.

Foolish Assumptions

We wrote this book believing that you're either an accounting student or a fairly new accountant still feeling your way around the field. For that reason, we assume that you know very little about how to identify, investigate, and prevent fraud.

However, we do assume that you bring a certain level of accounting knowledge with you:

- ✔ We trust that you have had a grounding in financial accounting. We don't explain the basics of debits and credits, trial balances, and the mechanics of preparing balance sheets and income statements. If you haven't yet taken an introductory accounting course, you need to do so for parts of this book to make sense.
- ✔ We also assume that, courtesy of your introductory accounting course(s), you know something about auditing as well. For that reason, we don't discuss the particulars of how an audit works. (We'd run out of pages in no time if we did so!)

Finally, we assume that you're truly interested in learning new and exciting stuff, and that you picked this particular book because you want to have fun reading it. We had a great time writing it, and we tried to make it enjoyable. We can just about guarantee it's more fun than any accounting textbook sitting on your shelf!

How This Book Is Organized

This book is divided into seven parts, each of which contains several chapters. Here, we run down what you find in each part.

Part I: Investigating Forensic Accounting

In Part I we provide an overview of forensic accounting, including what fraud is, who the buyers of forensic accounting services are, and what you should do when embarking on a career in forensic accounting. We discuss the most common types of fraud in the business and public sectors. And because not every forensic accounting engagement deals with fraud, we explain other types of engagements you will encounter during your career as a forensic accountant.

Part II: The Anatomy of Occupational Fraud

Occupational fraud is any type of fraud taking place within a business or institution (whether large or small). Part II starts out by discussing financial statement fraud, known as *cooking the books*. We then tell you about inventory fraud and revenue recognition issues. If you want to learn how businesses manipulate their own stock values and steer investor decisions that benefit the business (and often harm the investor), we give you that information as well.

Part III: It's All in the Family: Fraud against Individuals

Many forensic accountants work on cases that don't involve businesses or institutions. These chapters focus on the most common types of forensic accounting engagements that involve frauds perpetrated against friends, family members, and neighbors. You learn about what forensic accountants do when they're hired by individuals who suspect their soon-to-be ex-spouses aren't playing fair during divorce proceedings; when they investigate crimes that involve the elderly, estates, trusts, and life insurance; and when they're called on to help people defrauded by real estate schemes.

Part IV: Meeting Your Methods of Investigation

This part details the methods most commonly used by forensic accountants to discover and investigate occupational fraud, as well as fraud against individuals. We walk you through the investigation process, getting information about subjects, and using technology in finding fraud. We then discuss the crucial role played by the forensic accountant prior to and possibly during litigation. This part outlines those responsibilities and offers insights into the specific requirements for litigation involving government and business entities.

Part V: Preventing Occupational Fraud

Deterring fraud is as important as investigating it, and accountants often counsel their clients on fraud prevention. The goal of this part is to teach you internal controls and fraud-deterrence techniques that reduce the probability of fraud. Small and large businesses have their own unique issues that we explore in this part. We also discuss the types of technology available to keep a business secure from fraud.

Part VI: The Part of Tens

This part is probably the most fun of all. We give you three short chapters to whet your whistle for the forensic accounting field. We start with a list of ten portrayals of fraud in TV and in the movies that you may want to add to your “must-watch” list. We continue with a chapter about ten frauds that are fairly common but often unsuspected. And we conclude with ten truly strange fraud stories that may leave you shaking your head.

Also, assuming that you want to know more about forensic accounting after getting initiated, we provide a short appendix that lists valuable online resources to check out.

Icons Used in This Book

In the left margins of this book, you find the following icons, each of which alerts you to specific types of text:



The Case File icon sits next to real-life stories that relate to the topic at hand. Fortunately for us, the world is full of fraudsters who supplied ample fodder for this book. Read all about them where you see this icon.



The Tip icon alerts you to actions you can take to improve your chances of discovering, investigating, and following up on fraud.



When you see this icon, you know the information in that paragraph is worth tucking into your mental filing cabinet for future use.



On rare occasions, we delve a bit deeper into the subject matter than you may need to go. This icon lets you know that the paragraph contains in-depth information that may offer more details than a student or beginning forensic accountant needs.

Where to Go from Here

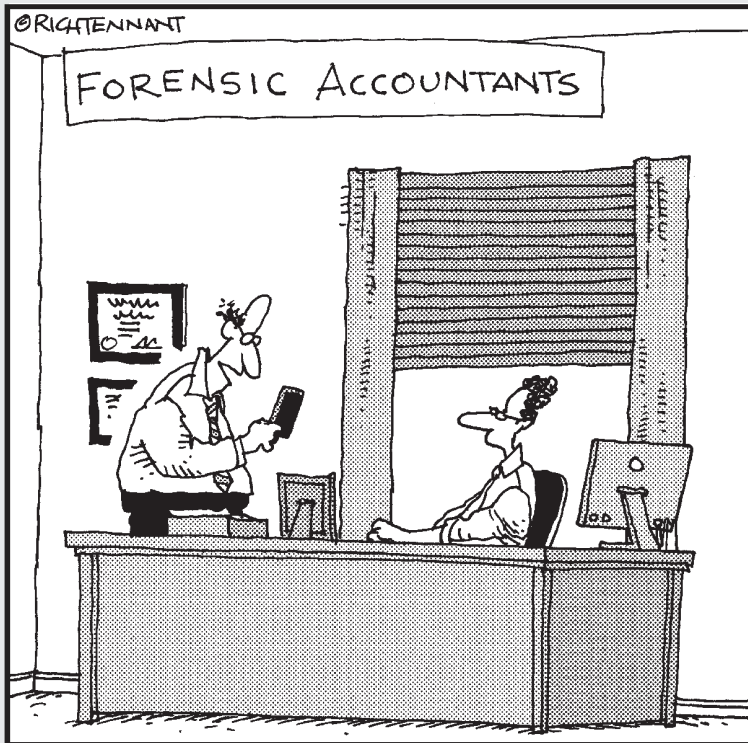
The beauty about this book is that you can jump in anywhere: We've designed it so you can start in the middle or at the end and easily understand everything we're saying. So spend a few minutes with the table of contents or index, locate a subject that's particularly interesting to you, and jump in! Or, if your mind is just too linear for that approach, feel free to turn the page and head to Chapter 1. Either way, we're confident you're going to enjoy the time you spend with us, so let's begin!

Part I

Investigating Forensic Accounting

The 5th Wave

By Rich Tennant



"Sweet. I didn't know Smith and Wesson made a calculator."

In this part . . .

We start at the very beginning, by explaining what forensic accountants do, how their work differs from the work done by other accountants and auditors, and how you can steer your career toward forensic accounting by taking the right courses and looking for the right types of jobs.

We then get deeper into the discussion of why forensic accountants are necessary (and becoming more in demand every day). The reason for this is because lots and lots of people commit fraud. We devote a whole chapter to outlining the most common types of fraud, focusing largely on those committed within businesses. Forensic accountants don't always deal with fraud, however, so we also offer a chapter explaining other types of work you may do as a forensic accountant.

Chapter 1

Why the World Needs Forensic Accountants

In This Chapter

- ▶ Keeping accounting and auditing straight
 - ▶ Figuring out what forensic accounting is
 - ▶ Getting an overview of fraud
 - ▶ Considering where forensic accountants work
-

Enron, WorldCom, Tyco, Bernie Madoff — their names are infamous, and they're all known to us for the same reason: fraud. Recent estimates indicate that almost \$3 trillion is lost globally to occupational fraud and abuse (the kind that occurs within a business) each year. That number would seem hard to believe if we hadn't all heard about the massive scale of fraud that has occurred at businesses such as Enron.

Investigating fraud can be complex. In a larger engagement, forensic accountants assist in performing various procedures that include reviewing millions and millions of documents, decoding financial information, interviewing scores of people, and gathering background information about key company players. Using technology is critical to the investigative process, and at the end of the investigation forensic accountants report their findings and sometimes provide testimony in a litigation context.

Forensic accounting as a profession has evolved in the past two decades. Recently, some universities and colleges have included it in their curricula. Organizations such as the Association of Certified Fraud Examiners (ACFE) and the American Institute of Certified Public Accountants (AICPA) now offer designations in fraud examination and forensics.

What motivates people to commit fraud? What are common types of fraud schemes? How can frauds be detected or prevented? How should they be investigated? These are some of the questions we explore in this book. To get you started, we offer an overview in this chapter of what forensic accounting is and why the proliferation of fraud has created such a strong need for it.

Accounting versus Auditing: Defining Our Terms

Accounting and auditing are substantially interrelated. In brief, *accounting* is the preparation of financial statements, and *auditing* is the examination of those financial statements. Every collegiate accounting program also offers auditing. Auditors have traditionally been certified public accountants (CPAs).

In this section, we examine accounting and auditing more closely to illustrate what they are and how they interrelate.

Working as an accountant

What is accounting? When Frimette teaches introductory accounting classes, she defines accounting as the gathering, analyzing, recording, summarizing, reporting, and interpretation of financial transactions for an entity. Wow, what a mouthful! What does it mean? Accountants gather information about transactions, record that information, and then massage it so that the end product is a set of financial statements that various types of users can use to make rational financial decisions about the entity.

The recipe that accountants use to do all this gathering, recording, and massaging is called *generally accepted accounting principles* or GAAP. Way back in 1494, a Franciscan monk in Venice named Friar Luca Pacioli published a book called *Summa de Arithmetica, Geometria, Proportioni et Proportionalita* (Everything about Arithmetic, Geometry, and Proportion). In it, Fr. Pacioli described the double-entry method of accounting — the method we still use today. *Double-entry accounting* reflects the fact that businesses have two sides:

- ✓ They have assets.
- ✓ They have claims on those assets, as well as sources that create the assets.

Although the basics of double-entry accounting have been around a while, business transactions have become much more complicated than they were in 1494. To refine how accounting should be used in today's complex world, we have guidelines. In the United States, these guidelines — GAAP — are determined by the Financial Accounting Standards Board (FASB), an accounting think tank in Norwich, Connecticut. Most developed countries have their own version of the FASB and GAAP. There is even an International Accounting Standards Board (IASB) that sets International Financial Reporting Standards (IFRS). All these systems of standards have a lot of similarities because they are all based on Fr. Pacioli's work.