Working in a Forensic Team

Unit

12

Unit 12

Working with Attorneys

Learning outcomes

By the end of this unit the learner will be able to:

- **Explain how forensic accounting investigators work**
- **Recognize the Forensic Accounting Investigator's Collaboration with Internal and External Auditors**

When an organization faces problems that require investigation, in-house or external counsel usually leads it or contributes towards the investigation. The forensic accounting investigator generally works with the counsel. The relationship between the forensic accounting investigator and counsel is the subject of this unit.

Teamwork with Forensic Accounting Investigators

In a financial crime investigation, forensic accounting investigators can make important contributions, only if they can work efficiently with the company's internal and external auditors, as well as with other elements involved in resolving suspicions or allegations of fraud. Forensic accounting investigators work in a high pressure atmosphere and present their findings at different forums, such as boardrooms, the courtroom or during hearings before government agencies.

All stakeholders in the process, including auditors, management, audit committee, and legal counsel must include the forensic accounting investigators in decision making processes regarding the investigation. One of the important decisions is generally the extent to which the forensic accounting investigators can work with and depend on the work of others, particularly the internal and external auditors. Another key decision is whether forensic accounting investigators should be added to the team that assesses the organization's business processes to strengthen the controls that allowed the fraud to occur. As the forensic accounting investigators have in-depth knowledge about accounting systems, controls, and typical fraud schemes, their input can be valuable.

The audit committee, management, or counsel acquiring the services of the forensic accounting investigators may be committed to a comprehensive investigation of all issues as they are eventually responsible for the investigation.

The audit committee can hire forensic accounting investigators independently and can consult them for appropriate guidelines to deal with the issues; alternatively, it may request the outside counsel to hire suitable forensic investigators. These FACs usually work for fulfilling the council's responsibilities towards the audit committee. In some cases, two forensic accounting teams work for the audit committee. One team that is hired by the external audit firm is responsible for assisting the external auditors to meet their 10A duties and provide guidance on the competency of the investigation conducted by the company. The other team that is employed by 10A counsel is responsible for an investigation that assists counsel and the audit committee in establishing whether an illegal act was committed and if so, which corrective actions should be taken to redeem it.

Forensic Accounting Investigators' Collaboration with Internal Auditors

Teaming with internal audit enhances both the efficiency and effectiveness of the investigation. Internal audit causes the investigation to be more directed because the internal audit knows the company, its staff and systems better than external forensic investigators. It may be best to work with internal audit in conducting investigations. There are number of important factors (explored later) that should be measured by the audit committee before they assign the responsibility of conducting an internal investigation.

Internal Audit's Position and Function

The position of the group in the company's administrative graph and its actual routine activities should be noted. Due to various factors, the daily activities may differ from the role prescribed by the organizational chart. It may be advisable to consider ways in which the internal auditor is measured by the company in relation to number of locations visited, coverage, improvements to operating metrics, types of issues raised and financial savings. Some of these considerations include:

- Is the internal audit unit attentive towards controls assurance that is characteristically demonstrated by location-based or compliance auditing- usually proved by early involvement in systems deployment or forward-looking projects?
- Does the internal audit plan work in accordance with IIA standards for a risk-based approach, usually in the form of a risk assessment? A coverage-based metric, such as a site visit to every location every three years is the proof that risk is not the primary driver.
- Does consensus exist within the organization regarding the role of the internal audit unit?
- Are any internal auditors qualified in forensic investigative accounting? Are they experienced? Do they provide a separate and distinct group of investigators? When fraud is suspected, do the internal auditors conduct investigations by means of this specialized group of forensic accounting investigators, or do they use auditors that have already been assigned to the specific project?
- Are internal audit's propositions implanted? If not, why not?

- What degree of collaboration exists between the internal audit group and the audit committee? Do the two meet frequently and discuss problems in depth, or do they meet only at formal meetings once a year?
- How is the auditor evaluated and by whom?

Working Together

After developing an in-depth understanding about the factors mentioned above, consider how the investigative team can work with the internal auditor and also make suggestions to the audit committee. Each group contributes different skills towards the task and the best solution is typically one in which collaboration of work happens. The internal auditors typically have the following expertise:

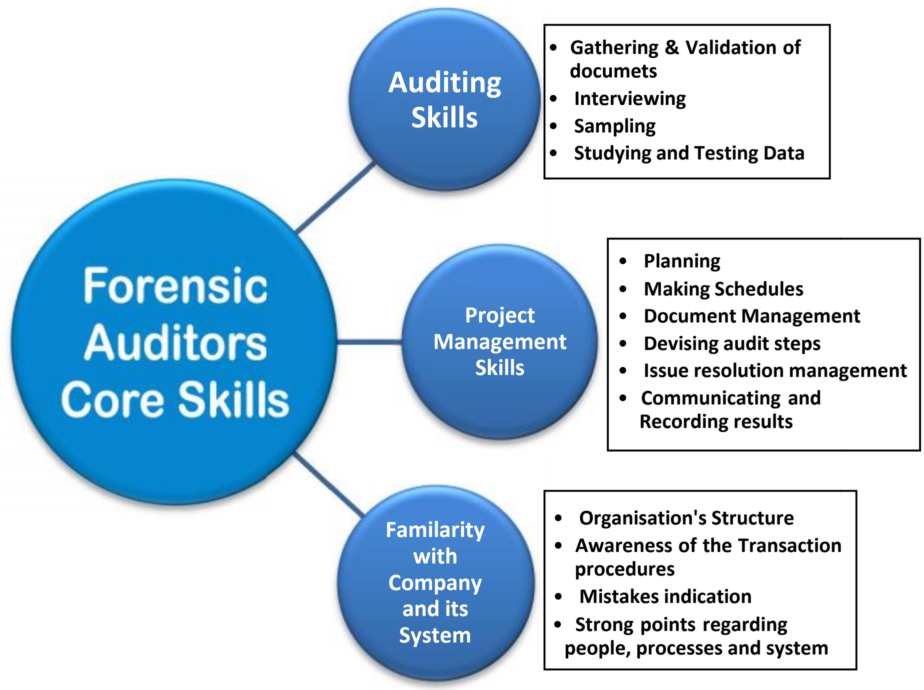

Fig: 12.1

- *Core auditing skills:* Gathering and validating documentation, interviewing, sampling, testing and studying the data.
- *Core project management skills:* Planning, making schedules, document management, devising audit steps including follow-up, issue resolution management, and communicating and recording results.
- *Familiarity with the company and its systems:* The organization's structure, how transactions take place, how mistakes are likely to indicate themselves, and the strong points of the company's people, processes and systems.

Having these capabilities places the internal auditor in a very strong position to obtain required background information on people, systems, and processes. Previous audits may also provide valuable insights. The auditor also functions as a valuable team member in gathering data or in functioning as a consultant to the forensic investigators on issues of approach, particular matters that come to light, and possible follow-up activities.

Forensic Accounting Investigators' Collaboration with External Auditors

The external auditors hired by a company are usually assigned to perform an audit according to generally accepted auditing standards, and the main focus of such external auditors is on auditing the financial statements according to professional standards. How effectively the forensic accounting investigators work in collaboration with external auditors, characteristically depends on several elements, comprising the following:

Client background

The external auditor may be a trusted adviser of the company or he may have a strained relationship with the company due to previous experiences. As the forensic accounting investigator works in collaboration with the company and its external auditor during an investigation, understanding the current relationship of the two is very important for successful communication during an investigation.

The forensic accounting team can improve its understanding of the client's systems, culture, and personnel by using the auditor's working papers and audit staff's help. The external auditors may require official access letters to gain access to information enclosed in the working papers. The terms of the access letters should be considered very carefully by counsel. Further, the process of obtaining access letters may cause delays and the investigation may not get started promptly.

External auditors can be very useful sources of information because they know the company better than a newly employed team of attorneys and forensic accounting investigators, who have limited prior experience with the company. The audit firm's knowledge about a company's areas of risk, business processes, documentation, systems, and employees can help the investigative team to get off to a quick start.

Aims of All Concerned Parties

The investigation conducted by the forensic accounting investigator must be independent and objective. The forensic accounting investigator should recognize the goals of all the concerned parties to the investigation.

Forensic Accounting Investigators' Objectives

The scope of the work and the desire to meet the objectives determine the forensic accounting investigators' objectives. Irrespective of the conflicting interests of the different constituencies, the forensic accounting investigators must generally answer the following queries:

- Who is involved in the fraud?

- Was the offender instructed by a higher administrator not currently a target of the investigation?
- Could there be partners in the conspiracy?
- How much or what is the total effect on the financial statements?
- Have all material schemes been identified?
- Over what time period did this happen?
- How did this happen?
- What can be done to discourage a recurrence?
- How was it detected and could it have been identified earlier?

Forensic accounting investigators must remember that they are basically the fact finders and that they have not been employed to reach to conclusions or to provide opinions. This differs from the financial auditor's role, who is appointed to audit the books and records and also to determine the nature, extent, and timing of audit procedures.

The management's obligations are the financial statements, and an auditor confirms that the financial statements have been prepared in accordance with standard accounting principles after completing required procedures and evaluating the outcomes. The forensic accounting investigator on the other hand holds a different set of skills and works according to the directions of an employer that may be the audit committee, management, counsel, or the auditing firm itself.

Selecting the audit procedures is audit team's responsibility; a step that is very critical and important. When auditors choose to register the services of subject matter experts such as forensic accounting investigators, they expect the investigators to offer suggestions on suitable procedures to be performed as well as related risks, costs and expected results. The investigators should be careful not to perform such procedures unless explicitly asked to do so by the audit team or whoever is directing the investigators. This approach can lead to frustration if forensic accounting investigators are ordered to stop during the course of an investigation.

If it occurs, this situation should be appropriately discussed with the audit team. The audit team is usually more well-informed about the client's business as well as other audit procedures that may alleviate the forensic investigator's concerns. However, the forensic accounting investigators should take directions from those who appoint them, whether they are the auditors, counsel or directors.

Other Parties' Objectives to the Investigation

Each concerned party may view the same facts differently during an investigation. For this reason, it is important to understand the preferences and objectives of all participants and to view any conflicts or differences in opinion that may appear in a broad context.

The *board of directors* is likely to focus on conducting a comprehensive and complete investigation through the independent members of the audit committee. The board members may be concerned about their personal liability and reputation and may lack the experience necessary to evaluate the effort. The board may depend on legal counsel and forensic accounting investigators to explain the parameters of the project.

Management may be eager to bring the investigation to a quick ending. The chief financial officer may be defensive based on his anxiety about how the organization permitted the fraud to occur. The CEO might be anxious about the investigation's influence on share price, company repute and liabilities, and also the morale of the employee. Perhaps due to mentioning cost or scope issues, the management's overall reaction may be to tightly manage the investigation.

Regulatory agencies such as the SEC and other law enforcement agencies have implementation and prosecutorial objectives outside the range of the investigative team's objectives.

Forensic accountants should not expect to be part of all activities usual for financial crime investigations. For instance, the forensic accountants may or may not be included in all interviews conducted by the legal team, instead they may be asked to attend only those interviews in which the legal team assumes accounting issues will surface. Forensic accountants are responsible for conducting the investigations in which counsel is involved, and will allocate resources accordingly.

The *external auditor* has several concerns:

- Whether the investigation team will conduct an investigation of sufficient scope?
- Whether the situation suggests retaining forensic accountants from the auditors' firm?
- Whether forensic accountants should be added to the audit team?
- Whether the investigation will question the quality of past audits?

The *internal auditor* may have different types of objectives, including;

- Not alienating management.
- Staying on schedule to complete the yearly audit plan.
- Not opening the internal audit team to criticism.

If the internal audit team did not detect the crime, it may also feel embarrassed, defensive and angry.

The company's *moneylenders* will most likely be concerned about their exposure to loss. The investigation may need to address the moneylenders' objectives if it takes place during a period of financing negotiations.

Stockholders may become worried once suggestions of financial impropriety become known. They may file a class-action lawsuit aimed at extracting the largest possible settlement from the company, the external auditors and other parties.

The *public* may feel some degree of interest in the investigation, mainly if the entity is a public, quasi-public, or charitable organization or if it is an important regional employer. These concerns are often reflected in and promoted by media attention, and create pressure to identify the cause of the fraud.

Who Should Lead the Investigation and Why?

Generally, a company's audit committee must lead the investigation proactively. Forensic accounting investigators track the evidence wherever it leads and communicates the outcomes to the audit committee or to the committee's designee, such as counsel, whose decisions direct the conduct of the investigation. While the external auditors must be pleased that the audit committee has directed an appropriate investigation, they neither direct the research nor decide what corrective actions are required by the situations.

Financial criminal activity research is filled with doubt, and one wrong move can generate dangerous outcomes. Audit committees identify the value of consulting with a qualified team of experts, such as counsel and forensic accounting investigators. A forensic accounting investigator working for an audit committee that does not look for assistance or that restricts the investigation would be strongly advised to resign from the assignment.

During an inquiry a time may come when the forensic accounting investigator is alone in supporting a certain approach or series of procedures. suppose if the audit committee interprets whistle-blower accusations as incriminating the revenue recognition practices of the company but not to the strategies involving the delay and repayment of related marketing costs, and forensic accounting investigator disagrees to this? What is the forensic accounting investigator to do?The evidence should be the controlling force in determining the scope and course of the investigation. On one hand, the investigator should be persistent in situations of this kind, while following the standards, methods, and practices that are most appropriate in the circumstances. On the other hand, decisions about the appropriateness of an investigation's scope depend on the audit committee, unlike decisions about the scope of the audit procedures, which depend exclusively on the auditors.

The forensic accounting investigator, preferably, should have an important impact on procedures which are related to the financial aspects of the investigation. Counsel should support the efforts of the forensic accounting investigator by providing suitable guidance and taking responsibility for the legal features of the matter. The audit committee may rely on other professionals, but in the end *it is the audit committee's investigation*. With the advice of other parties in the main team that influence the direction of investigation, the committee must take ownership. These may include forensic accounting investigators, legal counsel, internal and external auditors, and others such as a public relations firm. The forensic accounting investigator should encourage conferring early and frequently, which is often a routine in such matters.

In The Company of Lawyers

When a fraud is suspected, the first person to be contacted is characteristically in house counsel. Depending on the obvious severity of the matter and its evident location in the company, other internal resources to be alerted at an early stage may include corporate security, the controller's office, risk management, internal audit, and the public relations and investor relations groups. Investigations usually start with extensive discussions about who should be involved in the investigation, and the executives responsible may want to involve some or all of the functions just mentioned above.

Based on the circumstances, the group of internal auditors can in fact be a remarkable resource to an independent forensic investigative team. Internal auditors' knowledge of the company, as members in the larger team, may improve both the efficiency with which proof is collected and the forensic team's performance in organizing interviews and analysing results. The customer executives and in-house counsel should interact with an external team but it should also consider making available to that team the company's internal auditors and other in-house resources for any investigation of significant size.

In a number of circumstances, forensic accounting investigators may expect to work with or for attorneys, such as:

• Internal investigations related to accounting or reporting issues, generally generated by audit committee concerns, anonymous tips, internal audit concerns, media or regulatory reports or communications, or external auditor findings.

• Supervisory investigations such as investigations by Securities and Exchange Commission (SEC). These include civil court cases, such as contract disputes, investor lawsuits, illegal termination claims, fraud retrieval actions, and tax authority investigations.

Attorneys are of several different kinds. The forensic accounting investigator may work with the SEC counsel, general counsel for the company, special independent (external) counsel to the board or the audit committee, often designated as 10A counsel, lawyers for particular panel or audit committee members, counsel for particular staff members or groups of employees, civil or criminal counsel, or counsel for employees who may be under doubt or who wish to avoid being accused.

Confidential Requirements

The focus of any inquiry may be a material overstatement of asset values or understatement of liabilities. And there may be an immediate need to inform stakeholders and markets that already published financial statements may be not reliable. The level of the problem must be identified and corrective action should be taken. In that situation, a host of questions often circulate around the company:

- Was the misstatement made deliberately?
- Who knew or should have known?
- What actions need to be taken?

Maintaining confidentiality in such investigations is usually very important. Leaks of information to the press or competitors may be very damaging. The number of people within the company who are aware of daily developments should be suitably restricted from avoiding such leaks. However, during such investigations, the company may willingly choose to disclose information to regulators.

Establishing the Investigative Team

Forensic accounting investigators are called upon frequently to investigate potential financial statement misstatements or manipulations and asset misappropriations. Such engagements are referred to as internal accounting investigations. While investigating asset misappropriation, the forensic accounting investigator can be appointed by the external attorney or by the general counsel of the company.

During an asset misappropriation investigation the forensic accounting investigator typically receives excellent cooperation from company executives, who see themselves and the company as the victim. Based on past experiences, it has been seen that an investigation focused on asset misappropriation may produce evidence suggestive of other schemes, in which the company may have been gaining advantages from criminal acts. Once the forensic accounting investigator picks up on, a loose thread and tracks it, there often is no telling where it may lead. When potentially material accounting irregularities or accusations of potentially material fraud comes to light, the board of directors typically seek the advice of counsel on a number of considerations which may include the following:

- Initial communications with investors, employees, the market, shareholders, bondholders, moneylenders, and regulators.

- Creation of an independent committee to direct the investigation and regulate the company’s approach, typically comprising people from the board of directors and the audit committee.
- Establishment of an investigative team, usually through holding of appropriate counsel and other experts, such as forensic accounting investigators.
- Data safety and stabilization to avoid any loss of important information.
- Urgent decisions about employees, such as organizing for paid leave, limit of duties or access, and termination.
- Statement of insurance suppliers at the company and board levels.

The investigating team may include forensic accounting investigators, external auditor partner and important staff, forensic technology specialists and independent counsel.

The team may include other experts or specialists, based on the specifications of the investigation, including insurance experts, engineers, tax experts, valuation or assessment specialists, investment bankers and damages experts.

While working with lawyers, forensic accounting investigators should understand specifically:

- Their role and responsibilities regarding other team members.
- What other specialists are involved (existing or expected).
- The source and extent of any external investigation (SEC, IRS, DOJ, and so on).
- Expected timing issues, if any.
- Any legal concerns (degree of privilege, probability that the company intends to ignore privilege, prospect of criminal charges).
- Expected form, timing, and audience of short-term or final deliverables.
- Any restrictions on departments or staff that can be involved, interviewed, or used during the investigation process.
- Specific details of the matters under investigation, as presently understood by counsel.

With the help of forensic accounting investigators, independent counsel often takes the lead in setting up, managing and organizing the investigative team. The selection and retention of other parties who make up the team may be included in this process. Independent counsel’s duties characteristically include the following:

- Preparation, maintenance, and dissemination of a working-group list (very helpful in sorting out which law firms or experts represent whom).

- Establishment of the schedule in conjunction with the board of directors or management, distributing the schedule to the investigating team, and following progress against it.
- Gathering, submitting, and pursuing the various documents and employees access requests that the investigating team members will generate.
- Organizing the final report with or for the board or its special committee, or doing so in collaboration with other teams from which reports are forthcoming.
- Forming and maintaining communication channels with the board of directors and other interested parties, usually including internal general counsel, company management, regulatory staff, law enforcement or tax authority workers, and various other lawyers involved.
- Organizing client or team meetings and plans.

The forensic accounting investigator is frequently the cornerstone of a successful investigating team, although the attorney may officially lead the investigation.

For the larger team directed by the attorney, the forensic accounting investigator may provide the following types of help and support:

- Expertise in accounting, internal controls, regulatory (such as SEC) auditing, and financial investigation.
- Capability to plan and conduct a suitable financial crime investigation.
- Interviewing expertise; gaining evidence from witnesses and admission-seeking from suspects.
- Expertise in performing data interrogation and data mining of the company’s records, books, and e-mails.
- Knowledge in document verification and understanding of a network of experts trained in highly technical verification procedures such as typewriter/printer analysis and verification through forensic laboratory science.
- Ability to review and understand internal accounting transactions and their compliance with various rules.
- Forensic imaging and other information technology (IT) knowledge such as e-mail search tools.
- Ability to gather public financial and nonfinancial information, including SEC or company registry filings, if relevant.
- Providing support to counsel in developing various hypotheses, investigative procedures and techniques.

- Validity checks on vendors on the basis of publicly available information.
- Background checks on related staff.
- Preparing particular sections of the draft and final reports or support of counsel for report sections that focus on accounting, reporting, or financial information.
- Organization with both external and internal auditors and the audit committee.
- Evaluation and analysis of accounting, financial, or reporting analysis provided by other specialists.
- In larger firms, a global network of investigators to support in international investigations.

The forensic accounting investigator is often an important member of the team when investigations include review and analysis of accounting and financial information. For some attorneys, certain accounting concepts may be foreign, because they do not have extensive accounting or auditing experience.

The leading forensic accounting investigator should assemble a team for complex investigations that may involve public companies. That team should include the following skills and experience:

- The capability to assist or conduct the investigation.
- Knowledge about generally accepted accounting principles related to the current stage of the investigation.
- Sound understanding of SEC compliant financial disclosure, accounting, and other reporting.
- Knowledge about generally accepted auditing measures and principles.
- Awareness about regulatory investigative procedures.
- The expertise to instantly access specialist or industry knowledge when required, such as expertise in bank regulations and requirements, derivative financial instruments, and continuous contract accounting.
- Capability to identify variations from routine business practices and commercial conduct.
- Awareness about the uses and misuses of trusts and overseas companies.
- Appropriate language skills and abilities to meet the difficulties typical of a geologically diverse investigation.

Specifically, the forensic accounting investigator should be careful to avoid:

- Providing valuation guidance unless appropriately trained and credentialed.

- Providing legal advice or making legal declarations in their work.
- Acting as a judge or jury by making judgments as to the guilt or innocence of particular people or groups.
- Stating an audit opinion on internal control effectiveness or financial statements.
- Generating legal coverage based on remarks that may lead to claims of slander, libel or defamation.

Suggested Further Readings:

✓ Golden, T.W., Skalak, S., Clayton, M. (2006) A Guide to Forensic Accounting Investigation

✓ Wells, J. T. (2006) Principles of Fraud Examination

✓ Silverstone, H., Sheetz, M. (2006) Forensic Accounting and Fraud Investigation for Non-Experts, 2nd ed.