



“What You Need to Know About a Forensic Audit”

Massachusetts Collectors & Treasurers Association

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Today's Questions

- ▶ What is the difference between a Forensic and Regular Auditing?
- ▶ What does a Forensic Auditor Do?
- ▶ What type assignments are typical?
- ▶ Will our insurance bond reimburse the Town for the loss?
- ▶ What is expected from me?
- ▶ WHAT IF I AM THE TARGET???????

What is the First Thing I Should Know?

- ▶ THIS IS NOT GOING TO BE FUN!!
- ▶ Usually there is a lot more work that will be required from you.
- ▶ Something has occurred that management suspects foul play that usually involves the theft or misuse of Town assets.
- ▶ The engagement is highly charged as there is someone's reputation and livelihood is at stake.
- ▶ The elected officials may make statements that have not been proven or take actions that are premature.
 - This can make the engagement a lot more difficult because the press may be involved and staff is on leave.

What are Other Things I Should Know?

- ▶ Pressure may mount to complete the forensic work too quickly.
- ▶ Forensic work requires documentation that is suitable to be presented at court as litigation support. This takes time.
- ▶ As stated earlier, a person's reputation, livelihood and freedom may be at stake so the proper due diligence must be given to all matters.
- ▶ The Collector, Treasurer, Accountant, Selectmen, Mayor, Finance Director and others reputation and competency may be questioned.

What are Other Things I Should Know?

- ▶ The Independent Auditor's reputation and competency may also be questioned.
- ▶ There may not be enough evidence to make a conclusion. Records do disappear.
- ▶ The Forensic Auditor will ask you questions that make you uncomfortable.
- ▶ If you tell me that you are insulted by that question and are so outraged that you will not dignify that question with a response I immediately assume you are Guilty.

What are Other Things I Should Know?

- ▶ Staff may be unwilling or hesitant to cooperate for a variety of reasons.
 - They are afraid they may lose their job based on retribution
 - They may be involved
 - Their relative/friend may be involved
- ▶ You may be horrified and cannot believe a trusted employee/friend could do this and betray your trust.

What are Other Things I Should Know?

- ▶ You may be so mad that a theft occurred under your watch that objectivity flies out the window.
- ▶ You may be required to keep quiet about the matter until enough evidence is uncovered.
- ▶ This may be tough if the employee is working next to you each day.

What are Other Things I Should Know?

- ▶ If a staff member suspects wrongdoing by a superior it can be very hard to speak up.
- ▶ Once that superior leaves the Town it can be the opening for people to then speak up.
- ▶ Does your community have a whistleblower policy?

What is Forensic Accounting?

- ▶ Forensic means “Relating to, used in, or appropriate for courts of law or for public discussion or argumentation”
- ▶ Accounting means, “a system that provides quantitative information about finances”
- ▶ Forensic accounting is the application of accounting skills to provide quantitative financial information about matters before the courts

What is Forensic Accounting?

- ▶ The essential components of **FORENSIC ACCOUNTING** include an attempt to piece together or reconstruct a past event or events using financial information where that reconstruction is likely to be used in some judicial proceeding (e.g., criminal court, civil court, deposition, mediation, arbitration, settlement negotiation, plea bargaining).

What is a Fraud Investigation?

- ▶ Fraud means “***any act, expression, omission, or concealment calculated to deceive another to his or her disadvantage; specifically: a misrepresentation or concealment with reference to some fact material to a transaction that is made with knowledge of its falsity or in reckless disregard of its truth or falsity and with the intent to deceive another and that is reasonably relied on by the other who is injured thereby.***”

What is a Forensic CPA?

- ▶ A Forensic CPA applies specialized skills to collect, analyze and evaluate a financial situation, then communicate those findings to management or in a courtroom.
- ▶ It is the Art and Science of investigating People and Money!

What Transactions are the Subject of Forensic Audits?

- ▶ Mainly Fraud and Theft
 - Embezzlement & Employee Fraud
 - Cash – Departmental receipts
 - Inventory – scrap metal
 - Sick/Personal/Vacation Time
 - Procurement Fraud – kickbacks
 - Financial Statement fraud
 - Moving expense to next period or to grants

Forensic Audit vs. Financial Audit?

▶ Financial Audit

- Relies heavily on Internal Controls
- Tests are made as samples
- We do not look at every transaction
- We express an opinion on the financial statements
- Materiality plays a role in how we design our tests
- Our assessment of risk is another factor
- Our audit is not designed to catch all Fraud

Forensic Audit vs. Financial Audit?

- ▶ **Forensic Audit**
 - Relies on Internal Controls
 - Looks for “Holes in Controls”
 - Tests could be made as samples
 - We may look at every transaction
 - We do not express an opinion
 - We present facts but maybe not a conclusion due to scope limitation

Forensic Audit vs. Financial Audit?

▶ Forensic Audit

- Our Findings may be more critical than the Management Letter
- The deficiency may point directly at you for allowing lax controls which provided the opportunity for theft
- The report will have a section on questionable transactions and controls

What Happens Before our Findings/Report is Issued?

- ▶ Discussions with the Mayor/Selectmen/Town Manager/Town Counsel/District Attorney
- ▶ Usually in executive session
- ▶ Since this can be part of a criminal investigation our work product may be considered to fall under the Attorney/Client Privilege

What Happens Before our Findings/Report is Issued?

- Negotiations may occur with person under investigation to pay restitution, be fired but not prosecuted
- Police and District Attorney may request the report not be released until they complete their investigations.
 - It is not up to you whether a person is prosecuted.
- Report may go the Bonding Company

What Happens Before our Findings/Report is Issued?

- ▶ Once the report is accepted we provide management with the final report.
- ▶ Management decides how and when the report will be released to the public.
- ▶ The Town may sit on the report because the findings may be embarrassing?

What Happens after our Report is Released?

- ▶ A variety of things can happen based on the circumstances.
- ▶ If the case will be prosecuted then expect to be deposed.
- ▶ The prosecutor may require original documents and not accept our working paper copies.
- ▶ There may be personnel hearings to fire employees

What Happens after our Report is Released?

- ▶ The DOR usually has been aware of the forensic engagement early on.
- ▶ They will normally monitor the engagement and want to discuss the findings with the auditor and management
- ▶ If the findings are serious they will require continuous information related to the solutions

What Happens after our Report is Released?

- ▶ If the report is bad – expect bad things
- ▶ The Press is usually brutal
- ▶ Fingers will be pointed at everyone by everyone
- ▶ Everyone will promise Changes Will Be Made
- ▶ People may be fired
- ▶ Elections may be lost

Can I be Expected to Testify?

- ▶ Yes
- ▶ What Type of Witness will you be?
 - You can be very smart but a horrible witness
 - You need to be a good listener
 - You need to be confident and stick to your message
 - You must be able to think on your feet
 - You must know when to stop talking
 - You must know that it is ok to say you don't know something.

Can I be Expected to Testify?

- ▶ What Type of Witness will you be?
 - You need to be prepared for the defense team to tear you apart
 - They will blame you for having no policies and procedures.
 - No reconciliations
 - No training provided to their poor client
 - Why didn't inform them in writing that stealing is illegal?
 - Stay calm and keep to the facts.

Can I Prevent Fraud?

- ▶ No – but you can take steps to minimize it.
- ▶ Starts with understanding your own internal controls.
- ▶ Many times I find that management and staff do not know all the steps that occur in a transaction cycle.
- ▶ You should have this documented.
- ▶ The document will allow you to see more clearly the Holes in Controls.

Can I Prevent Fraud?

- ▶ Have you ever assessed the risk of fraud in your department?
- ▶ If theft were to occur where would it most likely to happen?
- ▶ Who would be more likely to steal?
- ▶ What is your own personal risk if a major theft occurred under your watch (assuming you are not the Thief)?
- ▶ **CONTROLS, CONTROLS, CONTROLS**



Questions & Discussion