

# UNIT-12

## Working in A Forensic Team

### 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

## Unit 12

### Working in A Forensic Team

In-house legal counsel or outside experts usually participate in or direct an investigation when such matters arise. This unit discusses the relationship between counsel and the forensic accounting investigator.

### Teaming With Forensic Accounting Investigators

Forensic accounting investigators can be key to a financial crime investigation if they are able to work well with internal and external auditors, as well as with any other people involved in the investigation.

Most forensic accounting work is done in a highly charged environment, and investigators have to present their findings in a variety of forums ranging from boardrooms and courtrooms to government agencies.

All stakeholders in the investigation, i.e. management, audit committee, auditors and legal counsels, should include forensic accountants in the decision-making process. The degree to which the forensic accountants are able to rely on and work with others such as internal and external auditors is an important decision. Another important decision is whether to involve forensic accountants, due to their extensive knowledge of accounting processes, controls and typical fraud schemes, in the team responsible for evaluating the organization's business processes and controls that made it possible for the fraud to occur.

The party engaging the forensic accountants, such as the audit committee, management, or counsel, is ultimately responsible for the investigation and may have wanted to involve the forensic accountants in order to conduct a thorough investigation.

The audit committee can either engage the forensic accounting investigators directly or ask outside counsel to engage them. The forensic accountants will usually work under the counsel's direction to fulfil their responsibilities to the audit committee. Sometimes the audit committee needs to work with two forensic teams. One is deployed by external auditors and is charged with assisting the external auditors in fulfilling their duties and ensuring the adequacy of the entity's investigative process, while the other team is engaged with the 10A counsel and is responsible for investigating whether an illegal act occurred and what remedial action is required.

## Forensic Accounting Investigators' Cooperation with Internal Auditors

Experience tends to confirm that conducting investigations together with internal auditors is more efficient, effective and targeted, as internal auditors know more about the company's personnel, its environment, and business processes than forensic investigators brought in from outside the company. In addition to working with the internal audit, those who are responsible for conducting the investigation, i.e. the audit committee, usually need to consider other important factors as well.

### Internal Audit's Position and Function

Internal audit's position in the organization as per the organizational chart and its day-to-day role should be noted. Sometimes its actual role is different from the one specified in the organizational chart for various reasons. The way in which the company measures its internal audit function with respect to coverage, number of locations visited, types of issues raised, improvement in operations, and financial savings should also be taken into consideration.

The following are some of the issues to consider:

- Is internal audit's primary focus on controls assurance, which involves location-based or compliance auditing, or on controls consulting, which involves forward-looking projects, early involvement in system deployments, etc.? Does internal audit perform risk assessments as per IIA standards? Conducting site visits to every location every three years would indicate that the prime focus is not on risk.
- Are internal auditors also trained in forensic investigative accounting? If they are, how experienced are they? Can they be categorized as a separate, distinct group of investigators? If a fraud is suspected, do internal auditors assign a specialized group of forensic accountants to investigate the fraud or do they simply assign the task to auditors who are already working on the particular project?
- Does everyone in the organization agree on the role of internal audit?
- Are the internal audit's recommendations implemented, and if not why not?

A number of other questions also require due consideration: Who evaluates the auditors and how? What is the degree of interaction between the internal audit group and the audit committee, i.e. do the two meet frequently to discuss matters in depth, or do they hold only a few formal meetings per year?

### Working Together

- After properly considering the factors mentioned above, the ways in which the investigative team might work with internal audit and make recommendations to the audit committee need to be determined. Both the investigative team and internal audit bring their own skills to the task, and the best way for them to conduct an effective investigation is to work together. Internal auditors usually bring the following skill set:

- *Core skills in auditing:* collecting documents and analyzing them for authenticity, corroborating evidence, testing and analyzing data, sampling, and interviewing.
- *Core skills in project management:* managing documents, planning, scheduling, creating and following up on audit steps, resolving issues, and recording and communicating results.
- *Knowledge of the company and systems:* knowing the organizational structure, how transactions occur, how errors can be revealed, and the strengths of the entity’s personnel, systems, and business processes.
- These attributes and skills enable an internal auditor to obtain background information on people, systems and processes. The auditors’ past experience in audit provides them with valuable insights. They not only collect important data but also serve as advisers to forensic accountants regarding specific issues and follow-up actions.

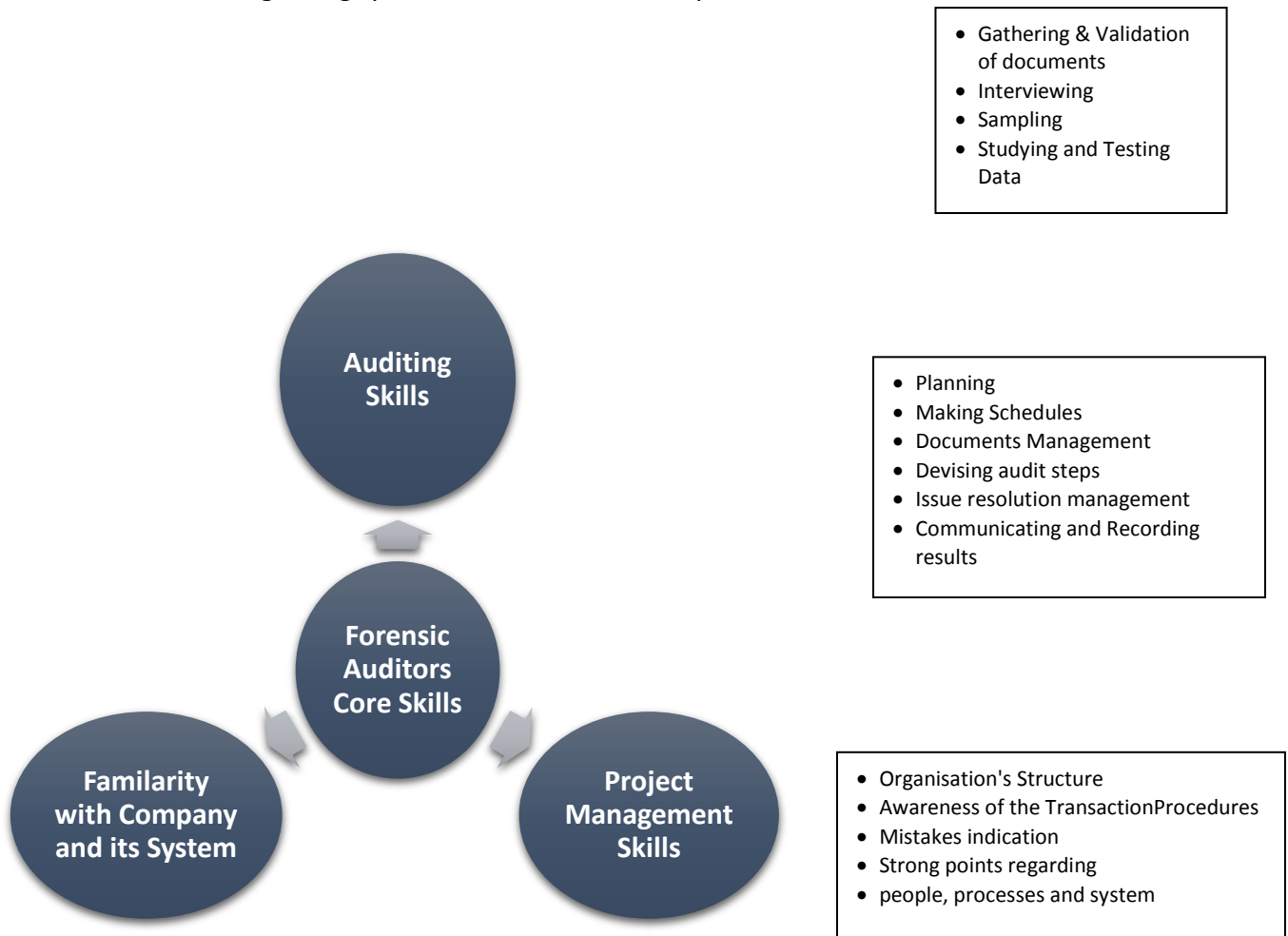


Fig. 12.1

## Forensic Accounting Investigators' Cooperation with External Auditors

The primary purpose of external auditors in an investigation is to audit financial statements and ensure that they conform to professional standards. They have to perform their duties under generally accepted auditing standards. The level of interaction between external auditors and forensic accountants depends on the following factors:

### Client History

The external auditor may have had a good past experience with the company as a trusted adviser or a strained relationship due to past events. In either case, forensic accountants must have an understanding of the current relationship between the external auditors and the company for successful and effective communication during the investigation.

External auditors are useful sources of information because they are more likely to know more about the company based on past experiences than a group of newly appointed forensic accountants and attorneys. Typically, the company's areas of risk, its business processes, documentation, systems, and personnel are issues about which the auditors are most informed, and they can therefore help the investigative team make a powerful start.

The forensic accounting team will also have access to the auditors' working papers and their staff, which will give them a better understanding of organizational culture and personnel. However, gaining access to working papers may require a formal access letter, the terms of which are set out carefully after advice from counsel. Obtaining these access letters may take time and delay the investigation.

## Objectives of All Interested Parties

The forensic accounting investigators are expected to be independent and objective and to have an understanding of the objectives of all interested parties involved in the investigation.

### Forensic Accounting Investigators' Objectives

Forensic accounting investigators' objectives are influenced by the scope of their work and their readiness to meet their clients' goals. However, regardless of the different goals of different clients, some of their basic objectives should involve answering the following questions:

- Who is involved?
- Is there a possibility that co-conspirators exist?
- Was the perpetrator instructed by a higher supervisor not currently a target of the investigation?
- What is the magnitude of the crime and what is its impact on financial statements?
- What was the time period over which the fraud occurred?
- Have all material schemes been identified?
- How did the fraud happen?

- How was it identified, and might it have been detected earlier?
- How can recurrence of fraud be avoided?

Forensic accounting investigators should be aware that their primary purpose is to find facts and not reach conclusions or express their own opinions. The financial auditor's role, on the other hand, extends to determining the nature, extent and timing of audit procedures after auditing financial books and records.

It is the management's responsibility to prepare financial statements, which are then analyzed by auditors to ensure that they conform to generally accepted standards after applying audit procedures and assessments. On the other hand, the forensic accounting investigator brings a different level of skill to the investigation and works under the direction of the employer through the management, the audit committee, the counsel or the auditing firm.

One of the most integral parts of an audit team's responsibilities is the selection of audit procedures, which relies on the auditors' judgement. When auditors seek the expertise of parties such as forensic accounting investigators, they expect to be advised on the appropriate procedures to be applied along with their costs, associated risks, and expected outcomes. The investigators are required to ensure that they are applying procedures on the audit team's orders or on the orders of whichever party is directing them. This can be frustrating for the investigators, as they may be ordered to suspend or end the investigation halfway through. In such a case, the investigators might discuss their issues with the audit team, although the fact that the audit team knows more about the organization and its procedures may address the investigators' concerns. In any case, forensic accounting investigators are required to take orders from their employers be they auditors, directors or counsel.

## Objectives of Other Parties to the Investigation

It is important to understand the biases and distinct objectives that may influence how different parties view the same facts differently, which may even give rise to conflict. In other words, stakeholders may have different points of view in the same investigation.

**Management:** The chief financial officer may adopt a defensive approach due to the fact that a fraud occurred under his/her watch and may be eager to wrap up the investigation as soon as possible. The CEO has to take other factors into consideration, such as how the investigation will impact the company's share prices, its reputation, employee morale, etc. Therefore, management's reaction will be to keep a close eye on the investigation by using cost and scope issues as an excuse.

**Board of Directors:** They will focus on conducting a thorough and objective investigation through independent members of the audit committee, as they themselves lack the expertise and the experience to conduct a fraud investigation. However, they may find the audit committee's efforts difficult to assess owing to their lack of skill in this particular area. The board will also seek assistance from legal counsel and forensic accounting investigators to set the scope and parameters of the project. They are also likely to be concerned about their reputation and liability.

**Regulatory agencies:** the SEC and other law enforcement agencies involved in the investigation will focus on enforcement and prosecutorial objectives, which have a larger scope than the investigative team's goals.

Forensic accounting investigators should not expect to be part of every activity involved in the investigation, as their role is dictated by the party directing them. For example, it is very likely that the legal team will not want forensic accountants to be involved in every interview, preferring them to assist in only those interviews where accounting issues are expected to surface. In investigations where counsel is involved, the counsel is usually responsible for conducting the investigations, assigning duties and allocating resources.

**Internal Auditor:** Working in cooperation with the management, completing the annual audit plan within the scheduled time period, and shielding the internal audit team from criticism are among the internal auditor's likely objectives. It is very likely that the internal audit team will feel embarrassed at failing to detect the fraud.

**External Auditor:** External auditors may have several concerns such as whether the investigation's scope will be adequate, whether the company's forensic accountants will be good enough for the job without having to involve more forensic accounting investigators, and whether this investigation will have implications for past audits.

**Stockholders:** Once the rumours of financial impropriety surface, the stockholders begin to have concerns. In reaction to this, they may file a class-action lawsuit in an attempt to secure the maximum possible settlement from the company and other stakeholders such as external auditors.

**Lenders:** They will most certainly be concerned about how the company's financial losses will affect them. In the event of the investigation taking place in the middle of financing negotiations between the company and its lenders, the lender's objectives will also have to be considered.

**Public at large:** The public may have a vested interest in the investigation, especially if the company is public, semi-public, a charitable organization, or a key regional employer. The public may exert significant pressure along with the media to resolve the situation through an effective and transparent investigation.

## Who Should Direct the Investigation and Why?

Generally, the company's audit committee leads the investigation and is at the helm of affairs. The forensic accounting investigators are responsible for following the evidence and communicating their results to the audit committee or to someone from the committee, such as the counsel, who conducts the investigation. External auditors must ensure that they are satisfied with the way the audit committee is running the investigation but they do not direct the investigation or decide the remedial actions.

There is a lot of uncertainty involved in financial crime investigations and one wrong move can have a harmful impact on the results of the investigation. Therefore, audit teams recognize the importance of consulting with a team of experts, advisers, legal counsel and forensic accounting investigators. A forensic accountant will not be able to perform his/her job effectively if the audit committee does not seek his/her advice or consistently intervene in the investigation.

During an investigation, a forensic accountant is likely to be alone in advocating an alternative point of view and suggesting a plan of action that has few supporters. For instance, the audit team may perceive allegations of fraud as implicating the company's revenue recognition practices rather than the policies on deferral or amortization of marketing costs, while the forensic accountant has a different point of view. Ideally, evidence should guide the scope and direction of the investigation. In situations where the audit committee and forensic accountants have differing views, the emphasis must be on following standards, methodologies and experience that guide the course of action. On the other hand, decisions involving the scope of the investigation rest with the audit committee, unlike decisions regarding the scope of audit procedures, which rest solely with the auditors.

The forensic accountant should have a key influence on the financial aspects of the investigation. Counsel must handle the legal issues in the investigation and support the financial accountants in their efforts through proper advice and guidance. Although the audit committee should seek and rely on these professionals' advice, ultimately it is *their* investigation. In other words, the audit team must take ownership of the investigation even though there are other significant parties working on it as well. These parties may include forensic accountants, legal counsel, public relations firm, internal and external auditors, etc. The forensic accounting investigator must strongly urge the committee to confer with all parties involved on a regular basis.

## In the Company of Lawyers

In-house counsel is the first party to be contacted when allegations of fraud arise. Then the audit committee contacts corporate security, internal audit, risk management, the controller's office, and public and investor relations groups depending on the severity of the matter and the location of the fraud. Investigations are typically initiated following a long conversation on who should be involved, and a responsible executive would want to involve all aforementioned functions of the organization.

Internal auditors are potentially great assets to the forensic investigative team. Their extensive knowledge of the company will help in gathering evidence, lining up interviews and analyzing findings efficiently. The company's executives and in-house counsel must engage external auditors, but they must also make their internal auditors and all other internal resources available to the external audit team.

There are a number of circumstances in which the forensic accountants should expect to work with attorneys. These include the following:

Internal investigations related to accounting and reporting, which are triggered by:

- Anonymous tips
- Audit committee concerns
- Internal audit concerns
- External auditor findings
- Media and regulatory reports or communications

Regulatory investigations conducted by the Securities and Exchange Commission (SEC)

- Tax authority inquiries
- Contract issues, shareholder lawsuits, wrongful termination claims, fraud recovery actions, and other forms of civil litigation

There are various types of attorney with whom a forensic accounting investigator might work. These include the company’s general counsel, SEC counsel, the board of directors’ or the audit committee’s external counsel (also called 10A counsel), attorneys for specific board or specific audit committee members, counsel for specific employees or groups of employees, civil or criminal counsel, counsel for employees who are under suspicion or who expect to be under suspicion, etc.

### Confidentiality Requirements

Investigations usually pick up and focus on material overstatements in assets or understatements in liabilities; therefore, the stakeholders need to be informed as a matter of urgency that past financial statements may be unreliable. Corrective action should be taken immediately after determining the problem. This will give rise to a few questions that will need to be addressed. For example: Was there a deliberate misstatement? Who knew, or who should have known about the misstatement? What needs to be done?

Confidentiality is one of the prime concerns in such an investigation, as any leaking of information to the media or competitors may be disastrous. In order to maintain confidentiality of the day-to-day developments in the investigation, it is important that the number of people who know about these developments is kept very limited. However, the company may be required to disclose information to regulators throughout the investigation.

## Forming the Investigative Team

Forensic accounting investigators are frequently called upon to investigate potential financial statement manipulations or misstatements and asset misappropriations. For the purposes of this discussion, we refer to such engagements as internal accounting investigations. When investigating asset misappropriation, the forensic accounting investigator may be engaged by the general counsel of a company or by the outside attorney who represents the company.

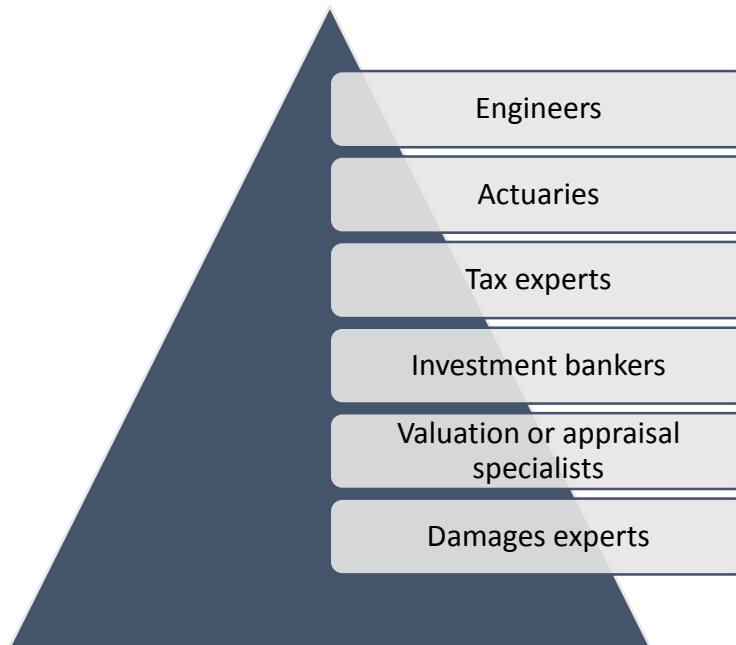
Usually, forensic accountants who are investigating asset misappropriations receive full cooperation from the executives because the company and the executives see themselves as the victims in such cases. However, according to experience most asset misappropriation investigations reveal other schemes from which the company may have been benefiting by committing illegal acts. When a forensic accounting investigator decides to follow a loose thread, there is no telling where the trail may lead. In case of material accounting irregularities, or suspicion of irregularities, the board of directors consult their counsel on a number of issues such as the following:

- Setting up an independent committee, which is usually a subset of the board of directors or the audit committee to lead the investigation and determine the company's course of action.
- Communicating with stakeholders, such as employees, the market, stockholders, bondholders, lenders, and regulators.
- Forming an investigation team comprising appropriate counsel and external experts such as forensic accounting investigators and specialists.
- Taking urgent decisions related to personnel such as paid leave, termination, and restricting duties or access.
- Stabilizing data and security in order to avoid information leaks.
- Notifying insurance providers at company and board levels.

The investigating team often includes:



- The team may also include other specialists based on the requirements of the investigation. These include:



Forensic accounting investigators should have an understanding of the following issues while working with attorneys:

- Their role and responsibilities associated with other team members.
- Which other professionals, current or prospective, are involved in the investigation.
- The extent and source of any external scrutiny by agencies such as SEC, IRS, DOJ, etc.
- Legal aspects such as the extent of privilege, expected criminal charges, expected extent of privilege waiver, etc.
- Anticipated timing issues.
- Expected form, timing, and audience of interim or final outcome.
- Specific matters related to the investigation as per counsel's understanding.
- Any limitations on departments or personnel that might be involved, interviewed, or utilized in the investigation process

Independent counsel, in cooperation with forensic accountants, often takes the initiative in setting up, managing and organizing an investigative team. During this process, the counsel may select or retain other parties involved in the team. The independent counsel's responsibilities include:

- Preparing, maintaining, and disseminating a working-group list, which may be helpful in sorting out law firms and their clients.
- Establishing a timetable together with the board of directors or the management, communicating that timetable to the investigative team, and tracking the investigation's progress according to the timetable.
- Compiling, submitting, and tracking various document and personnel access requests made by the investigating team.
- Organizing client or team meetings and their agendas.
- Preparing the final report in cooperation with and for the board of directors or its special committee or with other teams.
- Establishing and maintaining communication with the board of directors and other interested parties such as internal general counsel, company management, regulatory personnel, law enforcement or tax authority personnel, and various other attorneys involved.

While the attorney is ultimately responsible for leading a successful investigation, the forensic accountant is a key player in determining success.

The forensic accounting investigator might assist the team directed by the attorney in the following ways:

- Skills in planning and conducting a financial crime investigation.
- Expertise in accounting, in regulatory auditing, in internal controls, and in financial analysis.
- Interviewing skills including both fact-finding interviews with witnesses and admission-seeking with suspects.
- Expertise in data mining and data analysis of the company's books, records and electronic data such as e-mails.

- Experience in document authentication and awareness of a network of personnel trained in highly technical procedures such as typewriter/printer analysis and forensic laboratory authentication.
- Ability to review and analyze accounting transactions and their compliance with financial rules.
- Ability to gather both financial and non-financial information that is public.
- Expertise in forensic imaging, information technology, e-mail search tools, etc.
- Ability to provide assistance to counsel in developing various investigative techniques and procedures, and different hypotheses.
- Performing background checks on relevant personnel.
- Checking the validity of vendors based on publicly available information.
- Preparation of the sections of draft and final reports pertaining to accounting, reporting, and financial information and assisting the counsel during report preparation.
- Coordinating with internal and external auditors as well as the audit committee.
- Reviewing and critically analyzing financial statements, accounting reports, and advice provided by other experts and specialists.
- A global network of investigators might assist in multinational investigations.

A forensic accounting investigator has a key role to play in investigations that involve review and analysis of financial information and accounting transactions, as attorneys usually lack in-depth accounting and auditing knowledge and experience.

In complex investigations involving public companies, the lead forensic accounting investigator usually assembles a team of people possessing the following skills and expertise:

- Ability to conduct an investigation and provide assistance.
- Knowledge of generally accepted accounting principles relevant to the investigation.
- Knowledge of SEC rules pertaining to accounting, financial disclosure, and reporting.
- Familiarity with the investigative process
- Knowledge of generally accepted auditing standards and procedures
- Ability to gain immediate access to industry or specialist knowledge as required—for example, expertise in derivative financial instruments, bank regulation requirements, and long-term contract accounting.
- Experience in and knowledge of uses and abuses of offshore companies and trusts.
- Ability to identify non-conformity with customary commercial behaviour and best business practices.
- Language skills and the ability to meet challenges in investigations that are being carried out in geographically diverse locations.
- The forensic accountant should avoid the following:
  - Making legal statements or advising on legal matters during the investigation.
  - Guiding on valuation issues, unless they possess proper credentials and training.
  - Making judgements on someone's guilt or innocence.
  - Expressing audit opinions on the effectiveness of internal controls or financial statements.
- Note: Forensic accountants with accounting and auditing experience might legitimately comment on specific aspects of financial statements.

- Expressing opinions or commenting in a way that may create legal issues related to defamation, slander, and libel.

## Conclusion

In an investigation, a forensic accounting investigator is expected to work with or for attorneys. In order to ensure a smooth process that leads to satisfactory resolutions, each team member should take the following into consideration:

- Working in collaboration with the investigative team assembled by the client. This objective might be achieved through constant communication, such as conference calls.
- Communicating early on in the investigation and doing so frequently. In the event of disagreements on how to approach the investigation, which is fairly common, it is best to discuss the issues immediately and thoroughly to establish a mutual understanding.
- Both counsel and forensic accounting investigators bring to the team their unique skills, which are very important for the investigation's success. It is critical to demonstrate respect for each other's expertise and set egos aside for the greater purpose of serving the client.
- Fostering a conducive and cooperative environment that inspires the team to work together in order to complete the job.
- Managing the high-pressure environment of the investigation and acknowledging the possibility of external scrutiny.
- Understanding the rules pertaining to documentation, reporting, expectations of other parties, assistance expected from the client, 6(e) restriction, 10 (A) requirements, etc.
- Understanding roles and responsibilities in order to minimize confusion, duplication and lapses in the investigation process.

Qualified forensic accounting investigators and attorneys usually have a good work dynamic. They are appreciative of each other's professional skills and recognize that all team participants' contributions will lead to a successful resolution.

### Further Reading:

- ✓ *Manning, G. A. (2005) Financial Investigation and Forensic Accounting, 2nd ed.*
- ✓ *Golden, T.W., Skalak, S., Clayton, M. (2006) A Guide to Forensic Accounting Investigation*
- ✓ *Singleton, T., et al. (2006) Fraud Auditing and Forensic Accounting*
- ✓ *Silverstone, H., Sheetz, M. (2006) Forensic Accounting and Fraud Investigation for Non-Experts, 2nd ed.*