

CHAPTER THREE

3

Planning a fraud investigation

CHAPTER SUMMARY

Setting a strategy for a fraud investigation. Key parties in the organisation and the roles they should play. Beginning with the end in mind. The basic principles that apply to any fraud investigation. How best to deal with corruption involving senior or middle management. Case study: The role that basic expenses checks can play in nailing a corrupt fraudster.

■ SETTING THE STRATEGY FOR THE FRAUD INVESTIGATION

Whether you are the internal auditor or the line manager concerned, when a potential fraud comes to light you will need to get together with the key parties as a matter of urgency and plan your strategy to deal with the fraud.

Some golden rules apply here—and before I start I apologise for any offence I’m about to cause if you are either a lawyer or a forensic accountant (or indeed if you happen to be that rare animal, a police officer who has successfully investigated significant frauds). I am not criticising the legal profession, forensic accountancy or the police. It is simply that the best-run investigations are supported by experts, rather than controlled by them.

- Golden rule 1: *do not* put a lawyer in charge of your internal investigation.

A lawyer is concerned with the ins and outs of the legal system and, by and large, will investigate to the law. What you need in an investigation is early establishment of the facts, regardless of where the law might then take you. I speak with many years’ practical experience when I tell you that, generally, lawyers are not best placed or inclined to see the world in that light.

- Golden rule 2: *do not* put a forensic accountant in charge of your internal investigation.

Forensic accountants should support investigations, not run them. By and large their day comes when you need to prepare evidence for court. If you are not likely to go to court you shouldn’t need them. And they are far more expensive than doing it yourself. It is far better to use them to advise and assist, or, if you have the in-house skills and time, do the investigation yourself.

Some readers may already think that I’ve taken leave of my senses, especially as I’m about to give the next and probably most contentious golden rule for successful fraud investigation.

- Golden rule 3: *do not* call the police and ask them to investigate.

(At least, not just yet!) And I am speaking after many years’ experience of working with and for the police!

If you have a friend in the police who knows about fraud and in whom you trust, by all means speak to them. But otherwise, don’t waste your breath—or the police’s time—until you know exactly what you’ve got and what you need to do with it.



" YOU WANT US TO INVESTIGATE A FRAUD ? "



" I'M SORRY . WE DON'T HAVE ANYBODY AVAILABLE . "

You have to remember that the police are used to pursuing criminals when a crime has already been committed and identified or is happening as they watch. Fraud is not a specific target for the police and few detectives specialise in it. It is not the same thing at all as getting back the proceeds of crime or dealing with money laundering, two areas well understood by police officers who specialise in the financial side of crime.

In the early days of a fraud investigation you often won't know the scale of the problem or indeed if a crime has actually been committed, or by whom. None of these positions will endear you to the local CID, who'd much rather be out feeling a villain's collar, raiding a crack house or travelling to

somewhere nice in the Caribbean to find a witness to a dodgy drug deal or a shooting. Ploughing through your paperwork when they've got enough of their own already simply isn't anywhere on their list of things to do today, next week or indeed next month.

So if you shouldn't do any of the above, what should you do?

First, if there is a senior manager with the bigger picture or a chief internal auditor then they are probably best placed to oversee the preliminary investigation. If you are lucky enough to have an internal investigative department already set up, then they can do the initial work, provided it is reported to and overseen by a team chaired or led by the senior manager or chief internal auditor. The initial work may include securing or locating any potential evidence, although special circumstances may apply here (see Chapters 8 and 9).

By the initial work I mean the establishment of the basic facts of the matter under investigation. If an allegation has come in via a third party, then the initial work will include trying to contact the witness or person that first made the allegation and getting their story in their own words. This is not the actual investigation itself, although properly gathered evidence at this stage will eventually form part of the investigation material and may be used either in court or at disciplinary hearings later. Where, as in my last organisation, there are well-established processes for these matters, it is quite normal for the initial fact-finding enquiries on 'routine' internal and contractor frauds to take place without any involvement of senior managers or specialist advisers outside those within the internal investigations department. However, for a significant matter, or where there is no routine activity and internal department to conduct it, then the model below should apply.

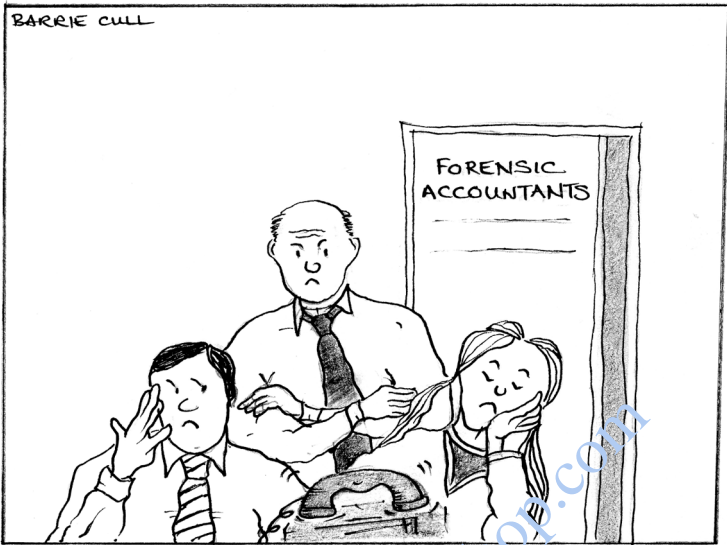
If internal fraud is suspected then other key players will include someone senior from human resources and the organisation's solicitor. For external fraud you may need your senior procurement adviser. You need to get the key management players together urgently and agree and record how you will proceed to conduct the initial investigation. That may seem strange but trust me on this one for now. You need to agree and note the key decisions taken—and a little about why you've taken them. It can all unravel horribly later on if you don't take these simple precautions at the beginning.

Likely key players—and their role—at this stage may include a selection of or all the following, whether your organisation is in the public or private sector:

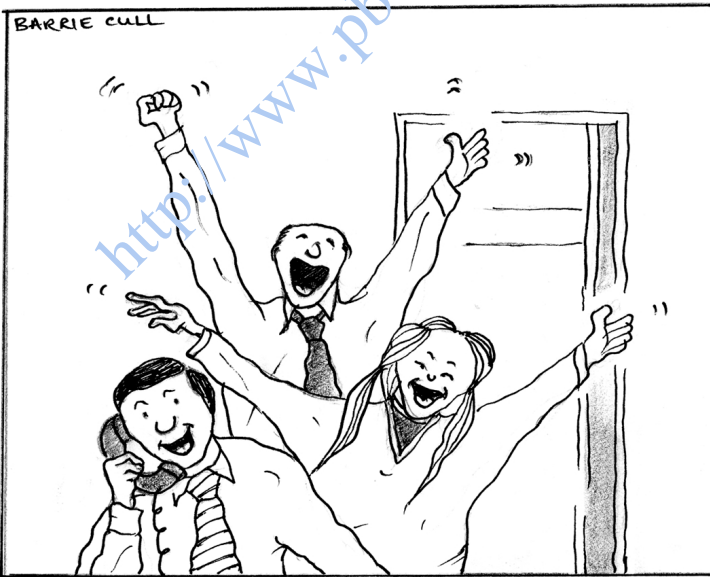
- (A) The ‘source’ of the allegation (by this I mean either the individual to whom the allegation has first been reported or the line manager, staff or auditor who has discovered the suspected fraud).

The source needs to explain why they suspect fraud and what they have done so far to the assembled senior team. Unless they will be actively involved in the investigation or potentially taking disciplinary action later their role will be limited to providing a suitably detailed account of what is known to date and making themselves available to answer questions to whoever will be running the initial fact-finding enquiries.

- (B) The senior responsible officer. Usually a top manager or, if such a role exists, the deputy chief executive, who will determine the overall strategy and appoint the person who will be charged with conducting the initial fact-finding enquiries.¹ They should receive regular updates from the investigator and keep the board (or for a lesser matter the appropriate senior management) in the picture.
- (C) The chief internal auditor/chief investigator (where such roles exist; may be one and the same or two separate individuals). If such individuals are not in post or the function is outsourced then it will be whoever is appointed to lead the investigation. Their role is to oversee the arrangements for the investigation and to act as the senior liaison and point of contact with others involved in conducting or advising the investigation.
- (D) The specialist investigator/auditor. They will be the lead individual conducting the preliminary enquiries before the actual investigation, either on their own or with a team. Depending on what happens next after the initial facts have been established, they may also end up leading the actual investigation that follows.
- (E) The organisation’s HR adviser on disciplinary matters. Particularly necessary where internal fraud is suspected, to ensure that the line between fact-finding and disciplinary process is understood and to make other parties aware of the legislation and organisational rules that may impact on the way in which the investigation can be conducted.
- (F) The organisation’s legal adviser. They have a dual role in protecting the organisation’s wider interests and in acting as the first port of call to obtain any specialist legal advice or potentially counsel’s opinion on evidence that comes to light.



" RING , RING "



" OF COURSE. WE'D BE DELIGHTED TO INVESTIGATE YOUR FRAUD ! "

Once the source has provided the necessary background to the suspected fraud the initial meeting can be quite brief, merely getting the senior responsible officer's approval for the preliminary enquiries and agreeing urgency, reporting arrangements and when next the parties concerned will meet to consider progress.

■ PLANNING THE INITIAL INVESTIGATION

This next rule may sound as tricky as the first time you had scientific sampling explained to you, but for any fraud investigation to have a chance of success you need to *begin with the end in mind*. It is no good setting off to investigate to the *n*th degree with a vast army of forensic accountants, auditors and lawyers trailing behind you trawling through every possible avenue. The investigation will quickly lose focus, almost as quickly as the costs will mount and the likelihood of a successful outcome will diminish. Whatever other ends you have in mind the first one, except in the rare case of a one-off fraud, will be to stop the fraud as quickly as you can!

It is wasteful, time-consuming and almost certainly pointless to send off an auditor or investigator with orders to gather every available document about the matter and see where it leads. And yet many chief internal auditors have done just that (and I include myself among that number, before I learned better of it, through practice and experience). Often the end in mind can be far more efficiently achieved with a short, sharp and focused investigation.

This is best illustrated by an example. Let us suppose that at Company Z James Dodger, Deputy Head of Procurement is suspected of favouring Company A in return for some on-going bribe, as yet to be discovered. What does Company Z want to do about this? There are a range of options and each one requires a different investigative response to achieve your organisation's objectives in that scenario.

- Option 1: Pay lip service in case shareholders or an external reviewer notice the problem later. High-level investigation only, by a trusted senior manager or director who can be relied upon to come to the right conclusion, followed by the discreet resignation of the Deputy Head of Procurement if he admits anything.
- Option 2: Play it low-key, but establish whether there is any evidence that should be given to the line manager for disciplinary

action. You will keep the investigation internal and in the hands of a trusted employee with no staff or specialist assistance.

- Option 3: Assume the worst but because of the current political climate you want to keep a low profile as an organisation. You will keep it internal but put your best available team on the job.
- Option 4: You are deeply concerned and want a full investigation as a matter of urgency. Integrity is ultimately more important to the long-term survival of the business than any short-term adverse publicity. You will work on the assumption that if you find evidence of his guilt, you will throw the proverbial book at him. This will involve the best available team and appropriate external professional support.

In other words, if the organisation's policy is to get rid of anyone suspected of a corrupt relationship, then your 'end in mind' is to establish as soon as you can whether there is sufficient information to sack the individual and, if not, whether you can find sufficient evidence to exonerate or not. If your organisation's policy is to keep a low profile unless there is a burden of proof, then time and outside support becomes a secondary planning issue.

Senior management will be looking for advice around the risks and potential outcomes associated with each course of action before deciding how best to proceed. This is where you need to have a clear view of your own responsibility and influence over any input into the decision. Experience shows that some outcomes can be predicted with a higher degree of certainty and likelihood than others.

The rough guide below may help clarify thoughts at this stage. Options for the end in mind deliberately do not include 'find the fraud' as finding a fraud is simply a useful stage along the journey to resolve the problem the fraud is likely to be causing to your organisation. It is not, of itself, an end in mind—although data-mining² specialists often seem to think that it is! The ends in mind are not mutually exclusive and it is acceptable to wish to pursue more than one of them with equal vigour. Possible ends in mind include

1. Prevent further losses to a fraud and recover as much as you can of the losses already sustained.
2. Be rid of a suspected lone fraudulent employee.
3. Be rid of a small group of suspected fraudulent employees.

4. Stop suspected fraud where no employees are clearly identifiable as the fraudsters.
5. Be rid of a fraudulent contactor.
6. Stop a fraud where no one contractor is identifiable as responsible.
7. Stop suspected collusion between a contractor and a member of staff to commit fraud.

End in mind 1 above usually goes hand in glove with one or more of ends in mind 2 to 7.

As a general rule, the early efforts of an investigation need to concentrate on how quickly and successfully further losses can be prevented, closely followed by an assessment of how difficult it will be to recover monies already lost to the fraud.

Once you know precisely how the fraud has occurred, audit staff can be tasked separately with working out whether any system changes would have prevented the fraud. I'll return to this subject in later chapters but the usual immediate 'gut' reaction of line management is to impose draconian levels of checks and controls that can tie the organisation in knots or slow down legitimate business, with the risk of creating more damage to the organisation than that caused by the fraud in the first place.

FIRST STEPS, STOPPING THE LOSSES AND STARTING THE INITIAL FACT-FINDING

This section concentrates on end in mind 1 in combination with 2. You suspect an individual is committing fraud, your management want to prevent further losses and recover already lost funds and they want to get rid of the individual concerned as quickly as they can.

The first and most obvious step is to remove the individual's means of committing the suspected fraud, so that you can immediately prevent any further losses. How far you can go with this depends on how much has come to light from the initial allegation or discovery.

The classic 'not to do' step at this stage—and I have seen otherwise sane and logical senior managers do it—is to call the suspected individual in, late on a Friday afternoon, confront them with the allegation and then ask for an explanation.

I make no apologies for reiterating this. *Do not, unless it is absolutely unavoidable, call in and confront any suspected internal fraudster in the office late*

in the day on a Friday. First, if they do confess you may well find it impossible to take any action until the following week, especially if you need to speak to others in Finance and HR but they've already left—or are in a nearby hospitality for the remarkably popular Friday night office drink before going home. Second, the suspect will now have the weekend to cover their tracks while your hands are tied. Third, if they are under extreme stress and/or covering for someone else they may collapse or self-harm over the weekend while mulling over your accusation and their own actions. Finally, if they brazen it out or accuse someone else, what are you going to be able to do about it late on a Friday afternoon that will have any effect?

One such manager, accused late on Friday afternoon, immediately offered his resignation, which was accepted. Over the weekend he persuaded the security guard to let him into the office (after all, no one had yet had time to tell the office that he'd resigned with immediate effect) and proceeded to destroy incriminating documents as well as help himself to spare keys, cash and stock, all loaded into a hired van with the helpful security guard's assistance!

Generally, it is a bad idea to confront a suspect with an allegation or rumour before you have conducted any background checks to establish the substance or otherwise of the allegation. It is a practical fact that many line managers will do this before the need for an investigation is realised. At worst a potentially successful investigation may be compromised and the fraudster now alerted to the fact that they are under suspicion and the net is closing in. At best it will muddy the waters and any unexpected admission of guilt will need a well-prepared and experienced line manager if it is not to lead to chaos and confusion. This is where appropriate fraud awareness training across the organisation can help reduce the likelihood of this scenario arising (see Chapter 17).

If a line manager does get into contact to say that they have confronted an individual who has admitted their part in a fraud before an investigation has been launched then you need to ensure that, as a minimum, the following steps have been taken:

1. The line manager has made a record of the salient points, either during the interview or immediately afterwards.
2. The line manager has applied any relevant HR policy with immediate effect, including suspension/removal from the premises of the individual concerned.
3. The line manager has taken steps to prevent the individual's access to

the organisation without supervision, including removal of physical and electronic passes and closing off their access to work IT systems.

4. The line manager has secured any relevant documentation or other media immediately available, preferably in a way that does not compromise any future evidential trail.³

It is not necessarily the end of the world if none of this has occurred but it will make it much harder both to investigate and to bring any criminal or disciplinary proceedings against the suspect. While retrospective action may miss the boat or leave the organisation at risk in the courts, it is still arguably far better than failing to take any steps to deal with the problem.

If, on the other hand, a line manager approaches you first with an allegation about a member of their staff (or indeed it comes to you via a third party and no one has confronted the suspect) then there is a chance to plan properly and get any subsequent investigation off to the best possible chance of success.

Common possible scenarios for the suspected fraudster at this initial stage include that

- a. They work in a finance or accounts department and are suspected of diverting funds though false invoices paid to a bogus company or an account under their control.

Initial action to take—either arrange their immediate suspension or, if possible, check the validity of suspicion by making a Companies House search or identifying an invoice unrelated to the organisation's business and then suspend once that evidence is found.

- b. They are a cashier or deal with accounts receivable and are suspected of diverting or suppressing income.

Initial action to take—undertake a surprise cash-up or check at the point they are processing funds. If anything at all suspicious is found then suspend immediately. If not, get the appropriate line manager to suspend as discreetly as possible, with a replacement cashier lined up to take temporary charge.

- c. They work in the warehousing part of the business and are suspected of diverting or stealing significant amounts of supplies.

Initial action to take—undertake a stock check of ‘at risk’ items and if discrepancies are found that link to the individual then suspend immediately. If not, get the appropriate line manager to suspend the individual more discreetly and use accurate information from the check to work back and identify whether significant amounts of stock are missing. If a stock check isn’t possible then consider searches of all staff on leaving the premises or alternatively whether delivery and issue information can be checked remotely.

- d. They work in the procurement part of the business and are suspected of bending the procurement process in favour of an existing or potential supplier.

Initial action to take—recover any relevant procurement files/documentation that can be picked up without alerting the suspect. Usually any completed supply process will be capable of acquisition or electronic access without alerting others to your interest. This area is always difficult to prove so be prepared to consider other options. For instance, do they claim any expenses or have a company car? Often fraudsters will turn their hand to any cash or asset that they can abuse and it is a lot simpler to nail them on expenses than prove a corrupt relationship.

If this isn’t possible could a bit of covert surveillance or even *agent provocateur* action get them to ‘show out’? Both these are high-risk, potentially expensive strategies and should only be considered if the other options are unlikely to get a result (see Chapter 8).

- e. They are a senior manager and are suspected of falsifying performance or accounting data to make their business look profitable or to hide losses.

Initial action to take—gather any of the performance/accounting data that can be checked independently of the senior manager under suspicion. This is one area where you are unlikely to get the individual suspended without absolutely cast iron evidence or 100% chief executive support. It is also a high-risk investigation as any mistakes could have dire consequences all round for the organisation.

With scenarios ‘a’ to ‘d’, where it would be impractical or dangerous to try to catch the individual in the act, wherever possible arrange for the line

manager to suspend the individual as soon as the initial suspicion can be linked to any factual material that supports it.⁴ It is an act that protects the organisation as a precautionary measure without accusing the individual at this stage. It is far better—at worst—to have to undo the suspension with suitable apologies all round later than to leave a potential fraudster in place while you search out the extent of the fraud.

Scenario 'e' requires a slightly different but realistic approach. In theory you don't treat any employee differently, however senior or near the top of the organisation. That is fine once the fact-finding has produced incontrovertible evidence, but in my experience when the facts are still being sought top-management's reluctance to act increases in direct proportion to the seniority of the suspect. So, concentrate your effort on the most likely item for a quick result. Again, if the area concerned is complicated to prove, look around for an easier option for quick evidence (e.g., their expenses claims). As internal fraudsters are usually after money it is almost a racing certainty that they won't pass up on the chance to fiddle their expenses.

■ EXPENSES—THE SHORT-CUT ROUTE TO SUCCESS

In order to understand the basics of fraud investigation, it is important to understand the dynamics of investigating in real time, as opposed to an after-the-event review. When suspected fraud first comes to light, it is often unclear and you can frequently be unsure how hard to press matters at that stage, particularly if the prime suspect is either a very senior manager or someone who is known to be aggressive or belligerent if anyone dares to challenge them.

Dealing with a senior manager: fraud case study (fictional example)

Case study: Part 1

This case study, although fictional, draws on a combination of facts and actions taken from a genuine case that crossed my path a few years ago. There is nothing described in it that has not happened in reality, either in that case or similar ones that cropped up later on.

Read the scenario set out below and then, where indicated, pause and consider what you think might be wrong and what course of action you would take at this point in time. If possible, do not read on until you have decided what should be done and have noted your initial thoughts.

Scenario background information

For the purposes of this exercise imagine that you are the internal audit team leader responsible for the audit of Research X, a government agency based in London that researches information technology and advises other government bodies. Research X is overseen by another government body, the Funding Agency for Research Organisations Using Technology (FAROUT). You are part of a consortia audit service which provides the internal audit both to FAROUT and to Research X. You report to the Chief Executive of FAROUT.

Research X spends about £50m a year, including £30m on IS consultancy and product purchases. It raises £25m a year in revenues by charging other government bodies for IS consultants and software licence fees. The rest of its funding comes from a government grant through FAROUT.

Research X has a director, Dr Sidney Smarmcharm, appointed a year ago on a three-year contract. Dr Smarmcharm brought with him a business manager, Miss Loyal, also on a three-year contract. Shortly after his appointment he also brought in a business consultant, on free loan from Haadyew, a global consultancy organisation not previously used by Research X. Popular rumour, passed on to you by the Finance Director at Research X, an old golfing partner, is that there is a very cosy relationship between Miss Loyal and the apparently 'happily married' Dr Smarmcharm.

Research X's Finance Director has also muttered about the number of times that Dr Smarmcharm has demanded some improvement to his office. Only last week he had a huge captain's desk delivered, even bigger than the desk of the Chair of FAROUT. Despite his mutterings, the Finance Director has continued to pay for the office improvements.

Monday 10th February, Research X: payments audit

Your team has started a routine payments audit at Research X. You have asked your one and only team member, an experienced but suitably cynical (and grumpy) internal auditor, to take a sample of payments and test them to see if appropriate controls have been correctly applied. He sets out to grab the nearest bunch of vouchers for testing, but you are wise to this and send him back again to get a proper scientific random sample. He sets off muttering about the 'waste of time' as 'nothing ever comes out of this anyway, what a ...' You miss the last word as he disappears out of sight on his way back to the Finance Office.

One of the items now properly selected for the sample is a claim for reimbursement by Dr Smarmcharm for a restaurant meal involving four consultants from Haadyew and four Research X staff, including Dr Smarmcharm and Miss Loyal. There is no restaurant bill to support his claim but there is the top copy of the personal Visa slip which shows £450 for a meal, although the line on it noting 'meal for X persons' seems to have the 'X' smudged out so that the number of persons can't be read. Dr Smarmcharm has noted that the electronic card reader was broken, hence the copy Visa slip.

Your cynical team member is suspicious of this item. He knows that under Research X's hospitality rules staff meals can only be reimbursed if there is at least as many outside consultants as internal staff. It seems odd that this item has been inked out on the Visa slip and there is no attached bill from the restaurant. Even if the card reader was broken, wouldn't they have provided a separate bill anyway? He holds the Visa slip up to the light and notices that it reads '7' in the bit that has been smudged out.

Now please write down your answer to the following questions before reading on further:

1. Is your cynical but experienced auditor right to be suspicious of this item?
Yes / No / Don't know
2. What course of action would you take next?
 - 2.1 No action?
 - 2.2 Look for further items of expenses claimed by Dr Smarmcharm?
 - 2.3 Go to the Director's office and ask Dr Smarmcharm for an explanation.
 - 2.4 Speak to Miss Loyal or Dr Smarmcharm's secretary about it?
 - 2.5 Check the expenditure on budgets and accounts controlled by Dr Smarmcharm?
 - 2.6 Combination of the above?
 - 2.7 Other action? (please specify).

Case study: Part 2—Tuesday 11 February–Wednesday 12 February

You decide to check any recent payments for expenses to Dr Smarmcharm. A quick comparison shows that he has spent far more in the last 12 months than his predecessor did in the previous three years.

<i>Expenditure</i>	<i>Dr Sidney Smarmcharm</i>	<i>Sir Titus Thrift penny</i>
Meals/entertainment	£3,760	£27
UK travelling/hotels	£2,566	£158
Overseas travel/hotels	£9,570	£505
Taxi fares	£1,320	None
Lodgings near office	£8,440	£4,753

The spend for Dr Smarmcharm's support unit includes £85,000 on 'office refurbishment' of which £15,000 appears to have been spent on a leather-topped desk for Dr Smarmcharm and a further £127,000 on two extra staff, Miss Loyal and an assistant for Miss Loyal.

A quick comparison of Miss Loyal's expenses claims show that she has

claimed a similar amount to Dr Smarmcharm in overseas travel and hotel costs, but only £250 for hotel expenditure in the UK and no travel, taxis or lodging claims.

Wednesday 12 February

In an unexpected moment of enthusiasm your team member calls a member of personnel he knows and asks them to let him have a look at Dr Smarmcharm and Miss Loyal's personal files, on the pretext that they may have been given the wrong start date on the payroll. In examining the files he notices two significant points. (1) Dr Smarmcharm only lives 20 miles from the office, although his predecessor lived over 100 miles away and needed occasional overnight lodging during the week. (2) Miss Loyal appears to have no previous experience as a business manager, as in her last job she was a junior official in a government computer procurement unit, of which Dr Smarmcharm was then the Deputy Head.

Now try the following questions:

3. Was your team member right to view the personnel files in this way?
4. Could the way the personnel files have been examined affect any later case against the Director or court proceedings?
5. How should you go about finding relevant personal information?
6. Now you have seen the patterns of expenditure should you seek to recover the original expenses claims, where they exist?
7. Should the recovery of expenses claims include Miss Loyal as well?
8. What other steps might you take at this stage?
9. Would you speak to anybody else about what has come to light so far?

Case study: Part 3—Monday 17 February–Wednesday 19 February

You and your team member have recovered a number of expenses claims from Finance for both Dr Smarmcharm and Miss Loyal. On examining and comparing them on UK travel and hotels you notice that Miss Loyal claimed a night's hotel costs in Birmingham for a computer conference. On her claim she has put that she travelled as a passenger in Dr Smarmcharm's officially provided car each way and that he picked her up and dropped her back at her flat in Little Horney, North London. Examination of Dr Smarmcharm's claim for the same period shows that he claimed for two nights in the Birmingham hotel and the car mileage with Miss Loyal shown as his passenger both ways. He has also put in an expenses voucher for a meal at £137, claiming that he dined out with the Managing Director of Haadyew, who was at the conference, as they could not go to the pre-booked hotel dinner because of the risk of being overheard by others at the same conference.

Thursday 20 February—11 a.m.

Your cynical team member has a bright idea. He rings up Miss Loyal, telling her he is calling from the Finance Department (this is technically true, although he neglects to mention that he is an auditor and not a finance clerk). He asks her over the phone if she stayed one or two nights in Birmingham. Miss Loyal is surprised by the question but adamant that she only stayed one night. Apparently Dr Smarmcharm had to be back in London by 2 p.m. the following day for a meeting. They had both stayed at the same hotel, the Exclusive, a five-star hotel that Dr Smarmcharm said was essential to their credibility. She recalled that they had dined there that night with the MD of Haadyew, dinner was included in the hotel price.

He then asks Miss Loyal if she can confirm the date claimed by Dr Smarmcharm for the meal with four Haadyew consultants and four staff from the original suspicious voucher. Miss Loyal checks her diary and says that there must be some mistake with the date on the claim. That day they had finished a major strategy review and as a reward Dr Smarmcharm had taken the six-strong team (including Miss Loyal) out for a slap-up meal. He had made a point of telling them he was paying for it himself as he knew the rules of Research X would not allow an official claim. They had all thought what a good egg he was.

Question time:

10. What risk has your member of staff run by making this telephone enquiry?
11. Is it valid to gather evidence in this way?
12. Can the evidence gathered be used in any subsequent criminal or disciplinary case?

Friday 21 February

On further examination of Dr Smarmcharm's claims, you realise that he has claimed full lodging allowances in a week last September when he was at a hotel in Amsterdam and not at his lodgings, a flat only a short walk from the office. The rules only allow for a reduced rate of claim when the lodgings are not being occupied. Looking back over his lodging allowance claims it is clear that he has regularly been claiming the full rate for staying there an average of three to four days a week, although his claims have reduced to one or two days a week since the Christmas break. You have a word with your old friend, Research X's Finance Director, about this. He is surprised—the lodging claims don't come through his office and he hadn't noticed the size or frequency of them. What particularly puzzles him is that he is pretty sure Dr Smarmcharm comes to work by officially provided car most days, it would be unlikely that he had driven such a short distance—although he did have a row recently with Dr Smarmcharm when he tried to get the Finance Director to pay for his and Miss

Loyal's parking fines for a night when they had both been illegally parked outside the flat.

Monday 24 February

In view of your mounting suspicions and the evidence gathered so far, you seek an urgent meeting with the Chief Executive of FAROUT to get his authority for a full and immediate investigation into all of Dr Smarmcharm's and Miss Loyal's expenses claims.

The Chief Executive of FAROUT, Sir Walter Underbridger, is very concerned and makes it plain that there are a number of wider issues to bear in mind here. Not least, they were just due to confirm Dr Smarmcharm in office and about to announce that he would be leading Research X into a new era as a fully commercial organisation, separated from FAROUT and the rest of government. The Prime Minister is due to make an announcement about it in the House just before the Easter recess.

Sir Walter is also a little personally concerned on the lodgings matter. He points out to you that he authorised the lodging arrangement himself and countersigns Dr Smarmcharm's lodgings claims before they are paid. He had already picked up the excessive use of lodgings and had told Dr Smarmcharm to reduce his number of days a week at the lodgings, which Dr Smarmcharm had now done. If, apart from that, the only concern was around errors in dates over a stay in Birmingham or a one-off clash between a week in Amsterdam and the lodgings claim, he couldn't see the justification for a potentially embarrassing investigation at a politically difficult time. Couldn't Finance simply adjust the overpayment and leave it at that? He could always have a quiet word with Dr Smarmcharm and remind him to take more care in submitting expenses claims in future. After all, in at most a year's time this would be no longer the business of FAROUT anyway.

At this point in a real case I needed to be at my most persuasive. The more senior an individual, the more important it is that they are above suspicion. For public office holders taxpayers have a right to expect officials to be both impartial and selfless in their duties and prudent with the public purse. Dr Smarmcharm has been far more costly than his predecessor. Although Sir Walter approved the lodging arrangement himself, it would be hard to justify it to any external scrutiny. Dr Smarmcharm lives 20 miles away, close to a main-line station where trains could bring him to London in 15 to 20 minutes. It is only a further 10-minute walk to the office from the London terminus. At the times when he claims to drive back and forth in the official car there would be relatively light traffic, again making it odd to see why an overnight stay would be necessary. He would have to be working very late to need to stay at the flat.

Looking at the matters that triggered the initial investigation, all the 'errors' have worked in Dr Smarmcharm's favour. There is also the clear alteration of the VISA slip. And Dr Smarmcharm seems to have a worryingly close relationship with the senior management of Haadyew. Miss Loyal does not appear to be appropriately qualified for the post that she holds and there is a

strong suspicion that there is a personal relationship between her and Dr Smarmcharm that could potentially be very damaging to the organisation.

It would be difficult to find any information to form a view about the appropriateness of the relationships either with Miss Loyal or Haadyew, but it would be a relatively simple matter to conduct a more detailed examination of the various claims for expenses made by Dr Smarmcharm and Miss Loyal. That would at least identify any further errors or causes for concern and provide either the grounds for exonerating Dr Smarmcharm and Miss Loyal or sufficient evidence for any disciplinary or criminal investigation.

Reluctantly Sir Walter agrees that these matters need examining in more detail. However, the work must be completed before the Prime Minister is due to make the announcement about the future of Research X. You have exactly one week to find sufficient evidence one way or the other.

Sir Walter also makes it plain that he doesn't want anything to get out about the investigation until you have established beyond all reasonable doubt whether the points you have identified on expenses are just the result of careless errors by a busy senior official or a deliberate attempt to defraud FAROUT and Research X.

Further questions to consider:

13. What steps would you take next?
14. How would you ensure that sufficient evidence has been examined in the time available?
15. What can be done without word of the fact-finding investigation spreading?

Case study: Part 4—Monday 24 February–Thursday 27 February

You and your cynical sidekick work flat out to examine all the financial records held by the system that relate to Dr Smarmcharm and Miss Loyal in the last 12 months, including expenses claims for travel and subsistence, petty cash claims for taxi reimbursements, expenditure on petrol for the official car and lodging claims. All are cross-mapped to see any unexpected results. In summary you find the following:

1. There are eight separate occasions where, according to Dr Smarmcharm, he and Miss Loyal travelled together in his car to conferences and stayed for either two or three nights and returned. In every instance Miss Loyal has claimed for being away one day less than is shown in Dr Smarmcharm's claim.
2. There are 15 instances where Dr Smarmcharm has claimed a taxi reimbursement on his expenses claim but his secretary had already claimed the money for him out of the petty cash.
3. There are two instances where Dr Smarmcharm has claimed petrol mileage for his official car to Heathrow and back, when flying out to conferences abroad. In

both cases he has also put in and been paid for the taxi fares to Heathrow and back.

4. There is one instance where Dr Smarmcharm appears to have claimed for the same return journey to Heathrow on the same days three times over. First, he has claimed full mileage rate while using a hire car, including diverting via Miss Loyal's home to collect her and drop her back home on the return journey. Second, he has claimed first-class rail fares from his home to Heathrow (and return) and finally he has also claimed taxi fares to and from Heathrow out of petty cash for the same two days.
5. When you check the invoice for the hire car, the paperwork shows that it was provided for two months as a replacement for a pool car 'loaned' to Dr Smarmcharm during his first six months in post, before he was provided with an official car. The pool car came complete with its own petrol card for getting it fuelled up. Looking at the fleet petrol card withdrawals during the period when Dr Smarmcharm did have the pool car, there are numerous occasions when the amount of petrol used to fill up the pool car exceeds its fuel tank capacity. You know from his expenses claims that when Dr Smarmcharm has used his own car from home to a conference and claimed the mileage he has a large vehicle with sufficient fuel tank capacity for that amount of fuel.

Friday 28 February—7 a.m.

You come into the office very early on Friday morning to write up your findings ready for taking them to the Chief Executive at 3 p.m. on Friday afternoon, as planned.

Friday 28 February—7:45 a.m.

To your surprise, the phone rings. The Chief Executive's secretary informs you that Sir Walter wants to see you in his office immediately. She indicates that he isn't very pleased about something and your name is mud.

When you arrive, Sir Walter tells you that Dr Smarmcharm has demanded an urgent meeting with him at 10 a.m. today. He doesn't know why, because Smarmcharm refused to tell him over the phone, but he can only assume that somehow Smarmcharm has found out about your investigation and he wants to know what he is supposed to do when Smarmcharm gets there. He makes it plain that you will be held responsible if Dr Smarmcharm takes out any kind of claim against FAROUT over this. He also demands that you find out before 10 a.m. how this information could have leaked out. Your investigation findings can wait until later, to avoid clouding his judgement when seeing Dr Smarmcharm.

As you are being ushered out of the office you can hear Sir Walter muttering, while shaking his head, 'I should never have allowed myself to be persuaded that an investigation was necessary, how am I going to explain this cock-up to the Prime Minister ... Why oh why didn't we appoint that other fellow, he wouldn't have been demanding investigations at the drop of a hat.'

You spend a miserable two hours thinking it all through but the explanation for the leak is obvious. It must have been that risky phone call to Miss Loyal. She has clearly spoken to Dr Smarmcharm about it. There is no other explanation that seems even remotely possible.

Friday 28 February—10 a.m.

Eventually you ring up Sir Walter's secretary to pass on the explanation. She seems surprisingly disinterested. 'Don't worry. The boss had another phone call from old smarmypants just after you left. He admitted he wants to see him about a job he's been offered in the private sector on far more money than we give him as the head of Research X—nothing to do with your investigation after all!'

Friday 28 February—3 p.m.

You turn up, armed with your report and supporting documents, to show Sir Walter what you have found to date. In the room, as well as Sir Walter, is FAROUT's head of HR and your old golfing pal from Research X, their Finance Director. Everyone listens attentively and it is clear that they all understand your findings and conclusions. They agree that Dr Smarmcharm has some serious explaining to do and, inexplicable as it seems for a man in his senior position, it looks like he has committed a number of petty frauds.

The head of HR explains that Dr Smarmcharm told Sir Walter at the 10 a.m. meeting that he is accepting the job he has been offered in the private sector and will be handing in his resignation to the Chair early next week. He has also indicated that he will be taking Miss Loyal with him. The Head of HR is firmly of the view that it would be best to forget this had ever happened and just let Dr Smarmcharm slide off into the private sector, never to darken Research X's doors again. Research X's Finance Director isn't so sure and is worried what else might come to light later. Sir Walter looks at you. 'Well, what is your view?'

The final question:

16. So what would you advise the organisation to do now?

- a. For the sake of the organisation let Dr Smarmcharm go and forget about it.
- b. Refuse to accept his resignation and suspend him while a full internal investigation is conducted.
- c. Call the police and ask them to investigate?

- d. Sack him immediately?
- e. Call him in and seek an explanation and then decide whether to accept his resignation or suspend him?
- f. None of the above? (please write down what you would advise instead)
- g. Some of the above? (please write down which options you would choose)

In a parallel real case the organisation in question refused to accept the resignation, suspended the senior officer and his business manager, called in the police and worked alongside them to complete the investigations. They discovered further discrepancies, including expenses claims made when technology companies had laid on and paid for everything, including flights and entertainment. Hotel rooms had been claimed by both of them when in fact he and his 'business manager' had shared a room. Even the costs of attending his interviews for the new job had been claimed off both organisations. The organisation that had offered the job withdrew their offer and when the police had completed their enquiries the senior officer was charged with a number of counts of theft (it was long before the Fraud Act). On being found guilty he was sent to prison, because, as the judge put it, he held a position of considerable trust that he had abused.

The business manager was allowed to resign and was never prosecuted. She had the defence that he had told her to make the hotel claims abroad and it was obvious from her expenses that apart from those occasions she had only claimed for her actual expenses, unlike her boss.

Some interesting patterns were apparent from the real case and have been reflected in the case study above. Signs were there for the more alert and naturally suspicious months before he came to Internal Audit's attention during the routine payments audit.

Had anyone looked properly at the lodging allowance request they would have noted not only the absurdity when he lived so close by and had two different ways of getting to and from work easily, but also that he had 'lifted' the body of his arguments for a lodging allowance from the letter written by his predecessor, who did live a significant distance away from the office.

The appointment of his business manager, who was patently under-qualified for the job, should have been challenged. Everyone in the office knew that she was really his mistress, but no one liked to speak up about it. In fact, when he was being vetted for his job, HR realised that he had a long

history of sexual liaisons with women at work or women from consultancy firms vying for government business, but it was decided that this wasn't any concern or risk to the day job, since he was clearly so self-interested.

The self-aggrandising spends on the office and captain's desk—and insistence on having an official car as well as a pool car were also signs of someone with little regard for the rules—or the public purse. Any examination of his budget would have shown a spiralling spend on matters connected with his own office and immediate staff.

His 'free' consultant. There is an old saying in business that there is no such thing as a free lunch. The same applies to consultants. A check of hospitality records would have shown that he had been entertained by the Managing Director of this consultancy on many occasions in a relatively short space of time.

It was normal for senior officers to have their expenses claims compiled by their secretaries and then just sign them. Instead he insisted on completing his own. Within weeks of making his first claims, he became embroiled in correspondence with the Finance Department, demanding that they pay for or reinstate items that they tried to adjust. Often the sums being argued over were unbelievably petty. All this pointed to someone who was overly obsessed with money and likely to commit fraud.

CASE STUDY: ANSWERS

As in real life, not all the answers are clear-cut—you will have to use your judgement!

1. Is your cynical but experienced auditor right to be suspicious of this item?

Yes!

2. What course of action would you take next?

Gather the available background information to decide whether you need to investigate. Don't 'do nothing' and don't confront the suspect!

3. Was your team member right to view the personnel files in this way?

No. It was unnecessary subterfuge. You should have a right to check supporting financial data to transactions. If necessary HR could ensure that you don't see any personal or medical information that is irrelevant to your

search. Fishing expeditions are looked on very dimly by both criminal and civil courts!

4. Could the way the personnel files have been examined affect any later case against the director or court proceedings?

Yes, adversely, if it comes to light.

5. How should you go about finding relevant personal information?

By asking the holder of the information to provide you with access to the information that relates to your enquiry.

6. Now you have seen the patterns of expenditure should you seek to recover the original expenses claims, where they exist?

Yes, as quickly and quietly as you can.

7. Should the recovery of expenses claims include Miss Loyal as well?

Yes—and anyone else whose claims might cross-refer.

8. What other steps might you take at this stage?

This one depends. I'd concentrate on expenses where he has to put in a claim of some sort to get them.

9. Would you speak to anybody else about what has come to light so far?

I'd be inclined to give the boss an early heads-up, in view of the seniority of the individual in whom I'm taking an interest. I certainly wouldn't be asking others or calling the police at this stage.

10. What risk has your member of staff run by making this telephone enquiry?

High risk of blowing out the case and alerting Dr Smarmcharm to the fact that you're on to him. Not recommended, although I have taken similar risks, but only when absolutely necessary.

11. Is it valid to gather evidence in this way?

A moot point. You could easily undermine your own credibility and integrity, leading to challenges to the rest of your evidence.

12. Can the evidence gathered be used in any subsequent criminal or disciplinary case?

Probably—but at court a stropmy judge or magistrate might just make you pay for it!

13. What steps would you take next?

Plan who is going to do what—and make sure that you read every bit of evidence you gather, that way the bigger picture becomes clearer.

14. How would you ensure that sufficient evidence has been examined in the time available?

Make sure that all claims for travel and subsistence are gathered and concentrate on 'errors' in them before checking other records.

15. What can be done without word of the fact-finding investigation spreading?

Anything that just involves the 'normal' collection of financial records for audit examination. If you start interviewing or asking questions, then it will get out before you are ready.

16. So, what would you advise the organisation to do now?

Tempting as it is for the organisation to let him go, you are a putative frauditor—we don't let them off the hook! Often senior management will automatically go for the quietest and easiest option. It is up to us to make them think very carefully about what is right and fair in such circumstances. Also, if a top dog gets away with it, the cultural damage down the organisation can be far more catastrophic than any publicity over pursuing a senior official for expenses fraud.

General principles and axioms from Chapter 3

The best-run investigations are supported by experts, rather than controlled by them.

Golden rule 1: *do not* put a lawyer in charge of your internal investigation

A lawyer will investigate to the law. What you need in an investigation is early establishment of the facts, regardless of where the law might take you.

Golden rule 2: *do not* put a forensic accountant in charge of your internal investigation

Forensic accountants should support investigations, not run them.

Golden Rule 3: *do not* call the police and ask them to investigate

- If you have a friend in the police who knows about fraud and in whom you trust, by all means speak to them. But otherwise, don't waste your breath—or the police's time—until you know exactly what you've got and what you need to do with it.
- Fraud is not a specific target for the police and few detectives specialise in it.
- At the start of the investigation you need to get the key management players together urgently and agree and record how you will proceed to conduct the initial investigation.
- For any fraud investigation to have a chance of success you need to *begin with the end in mind*.
- Often the end in mind can be far more efficiently achieved with a short, sharp and focused investigation.
- The early efforts of an investigation need to concentrate on how quickly and successfully further losses can be prevented, closely followed by an assessment of how difficult it will be to recover monies already lost.
- *Do not, unless it is absolutely unavoidable, call in and confront any suspected internal fraudster in the office late in the day on a Friday.*
- Generally, it is a bad idea to confront a suspect with an allegation or rumour before you have conducted any background checks to establish the substance or otherwise of the allegation. It is a practical fact that many line managers will do this before the need for an investigation is realised.
- When the facts are still being sought, top-management's reluctance to act increases in direct proportion to the seniority of the suspect. Concentrate your effort on the most likely item for a quick result. If the area concerned is complicated to prove, look around for an easier option for quick evidence (e.g., expenses claims).