



# **Association of Inspectors General Certified Inspector General Auditor course**

## **Forensic Auditing**

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# Governmental Auditing

The Government Auditing Standards defines the types of government engagements as:

- Financial
- Attestation engagement
- Performance audit

# **Financial Audit**

Financial Audits are primarily concerned with providing reasonable assurance about whether the financial statements are presented fairly in all material respects in conformity with generally accepted accounting principles (GAAP), or with a comprehensive basis of accounting other than GAAP.

# Attestation Engagement

An attestation engagement concerns examining, reviewing, or performing agreed-upon procedures on a subject matter or an assertion about a subject matter and reporting on the results. The subject matter of an attestation engagement may take many forms, including historical or prospective performance or condition, physical characteristics, historical events, analyses, systems and processes, or behavior. Attestation engagements can cover a broad range of financial or non financial subjects and can be part of a financial audit or performance audit.

# Performance Audit

Performance audits entail an objective and systematic examination of evidence to provide an independent assessment of the performance and management of a program against objective criteria as well as assessments that provide a prospective focus or that synthesize information on best practices or cross cutting issues.

Performance audits provide information to improve program operations and facilitate decision making by parties with responsibility to oversee or initiate corrective action, and improve public accountability.

# Forensic Audit

A forensic audit draws its name from association with a court of record; forensic audits are normally performed to accomplish an objective that involves a judicial determination. For example, an effective fraud auditor should be able to:

- 1- design scenarios of potential fraud losses based on identified weaknesses in internal controls;
- 2- Identify questionable transactions; and
- 3- distinguish simple human errors and omissions in entries from fraudulent entries.

# Forensic Audit

Per the managing partner for Grant Thornton's Western Region Economic Advisory Practice, Bred Preber, "There is a lack of understanding regarding forensic procedures and their application, and this lack is not limited to the public at large. Forensic auditing is a relatively new type of audit and there are no generally recognized standards developed to perform a forensic audit. If the forensic audit is approached as an open book to see if you can find anything, the results will be outrageously expensive and [will raise significant issues of potential liability because you are searching for that you aren't sure exists."

[Source: <http://www.cfo.com/article.cfm/8759510>]

# Definition of Fraud

The intentional, wrongful obtaining of either money or some other advantage or benefit from government programs. Fraud includes theft, embezzlement, false statements, illegal commissions, kickbacks, conspiracies, obtaining contracts through collusive arrangements, and similar devices.



# Further Classification of Fraud

## Corruption

- Bribery/Kickbacks
- Conflicts of Interest  
(Arms Length)

## Embezzlement

- Skimming
- Fraudulent  
Disbursements
- Shell Company

## Fraudulent Statements

Over/Under Statement of Assets  
i.e., financial statement fraud

# **Auditing Standard (Fraud)**

**SAS 99**

**Yellow Book**

# **Elements of Fraud**

- 1. False Representation**
- 2. Willfulness/knowingly**
- 3. Reliance**
- 4. Injury**

# Red Flag

- Circumstances or situations that are unusual, i.e., vary from the norm
- A “tell” or signal/sign that something may be unordinary – needs further review

# Examples of Red Flags

## Employee

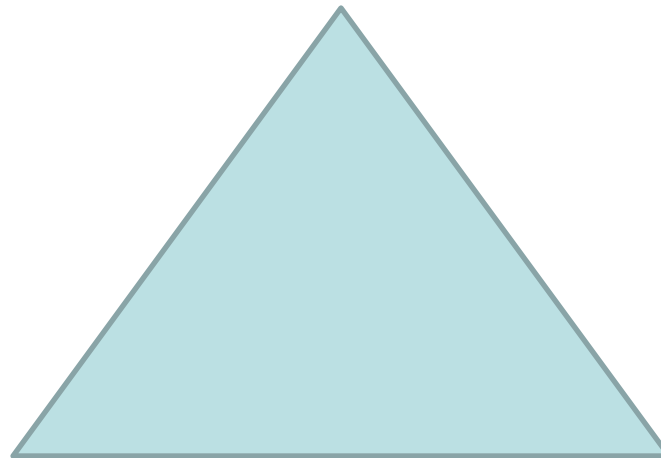
- Lifestyle Changes
- Excessive number of bank accounts
- Behavioral changes

## Management

- No taking of vacation
- Frequent changes in external auditors
- Company assets sold under market value

# The Fraud Triangle

Opportunity



Attitudes/  
Rationalization

Incentives/  
Pressure

Rationalization

Pressure

# Why a Fraud Might Be Perpetrated

- Opportunity – events exist that provide an opportunity for fraud to be perpetrated – i.e., override of controls, absence of controls
- Attitudes or Rationalization – people committing the fraud justify it in their minds
- Incentives or pressures – employees or managers have an incentive or a real-or-perceived pressure to commit fraud

# Forensic Auditor - Characteristics

- Question – Be inquisitive – W.W.W.H.
- Perseverance – Be a real junk-yard dog
- Problem-Solver – Put the puzzle together
- Skepticism – An attitude of Doubt
- Independent – Free to make the right call



# Auditor - Methodology

- Validation – Assets, Deliverables, People
- Knowledge – Know the area you are reviewing
- Communication – Interviews, Coordination,  
Testimony

# Techniques

- Data Mining – The automatic extraction of information, possibly unknown information from large data bases or datasets (hidden patterns)
- Trend Analysis – Changes in inventory, production statistics, unusual MTB for replacement, MTTR
- Ratio Analysis – i.e., current ratio: current assets divided by current liabilities  
Embezzlement will cause ration to decrease

# Case Discussion - OTR – Embezzlement

- **Harriette Walters**, mastermind of a nearly two-decade tax scam that cost D.C. taxpayers almost \$48 million, will get 17 years and six months for her crimes. she will also make restitution for the \$48 million that she stole...pay \$12 million in tax payments to the federal government and \$3.2 million to the District.



# Case Discussion - OTR – Embezzlement

- Walters used her position at OTR to create false property tax refund vouchers that produced millions of dollars of fraudulent refund checks. From June 1989 through August 2007

# Background

- Mid 1980's – (low-level mgr in OTR) becomes involved with co-workers in a fraudulent tax refund scheme
- Late 1980's – Walter's takes charge – her own embezzlement scheme – fraudulent real property tax refunds – 5k – 500k
- Continues through 1990's Average fraudulent refund processed by Walters was about \$275,000
- Nov 2007 – Investigators announce the arrest of OTR employees

# Review Teams

- OIG (Investigators and Auditors)
- FBI
- AUSA
- Independent Auditors (forensic)
- Special Task Force (Wilmer Hale)



- Shopping sprees at Nordstrom, Neiman Marcus - \$2.3 million
- Designer purse - \$25K
- 45 trips to Las Vegas and Atlantic City
- Cash and checks to co-workers \$1.2million

Classification  
of  
Fraud Triangle Elements



# Negative Impacts

- Financial Loss
- Dollars were needed for City services
- Staggering Embarrassment
- Employees Fired
- Employees Resigned
- Cost of forensic audit work

# End Results of Investigative/Audit Work

- Tax Scam leader sentenced to 17.5 years (others lesser time)
- Recovered about \$10 million
- Improved Systems
- Different Management
- Improved Internal Controls

# **Criminal Statues**

- False Statements – 18 U.S.C. 1001
- False Claims – 18 U.S.C. 286 – 287
- Theft – 18 U.S.C. -641
- Computer Fraud – 18 U.S.C.1029/1030