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How forensic accountants dig deep to solve crimes

Martin Daks (https://njbiz.com/author/martindaks27/) // October 9, 2023 // Minute Read

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When a bankruptcy trustee was investigating a former New Jersey senator (no, not the one currently in the news (https://njbiz.com/booker-agrees-as-calls-mount-for-menendez-to-resign/)) who had filed for bankruptcy, information was identified that raised suspicions about the potential

for money laundering. But then the investigators hit a stone wall and decided to call in the heavyweights: a team of forensic accountants.

“After the trustee secured a search warrant and coordinated with the U.S. Marshals, we entered the ex-senator’s residences and found tens of thousands of dollars, in piles scattered around the homes,” said Ken DeGraw, a **Withum** (<https://www.withum.com/>) partner and market leader in the firm’s Financial Distress and Recovery Services practice. “When we dug a bit deeper, at least two other important discoveries emerged: the individual was maintaining multiple entities and shuffling funds through them; it also appeared that most of the cash we found had never passed through a bank account – both classic signs of money laundering. The case is still being litigated.”



DeGraw

Forensic specialists are like the “NCIS” or “Criminal Minds” of the accounting profession. Freed from straitjacket rules like GAAP (https://www.ojp.gov/sites/g/les/xyckuh241/les/media/document/GAAP_Guide_Sheet_508.pdf) (Generally Accepted Accounting Principles) and standards that govern traditional audit, attestation and advisory services, forensic accountants can follow their inner Sherlock in pursuit of evidence – even if it implicates the party that hired them.

“When people think of CPAs, they tend to think of tax or audit engagements, which are both bound by regulatory rules and professional standards,” DeGraw explained. “Forensic accountants start with many of the audit and other skills that accountants typically use, and then add a kind of improv to put pieces of a puzzle together. We’re looking at scraps of information, tracing cash deposits, withdrawals, wire transfers and other activity, and reviewing contracts and other documents. It’s like trying to put Humpty Dumpty back together again.”

Unlike a lawyer, who is hired to advocate for their client, “We go where the evidence leads us,” added DeGraw. “We’re not hired guns – instead, we advocate for our own reasoned opinion.”

His engagements aren’t limited to criminal matters. “We’re doing more business disputes and matrimonial cases,” he noted. “During divorce proceedings, for example, one spouse may suspect the other is hiding his or her assets in an effort to reduce alimony or other support payments. Unfortunately, that segment has seen a rebound from the COVID pandemic period, when people were sort of forced to stay with each other.”

DeGraw is also seeing more investigations related to COVID-era stimulus programs. “We keep getting called in to investigate possible fraud among businesses that claimed PPP [Paycheck Protection Program] and ERC [Employee Retention Credit] benefits,” he said.

The ERC is a credit (<https://njbiz.com/njbiz-conversations-gina-perrone/>) that has been available to eligible employers that paid qualified wages to some or all employees after March 12, 2020, and before Jan. 1, 2022. The IRS was flooded with applications, and recently suspended processing them due to suspicions of widespread fraud resulting from the aggressive promotion of the credit by what the agency refers to as ERC mills.

“Our valuation unit may also get called in when business owners adopt an ESOP [employee stock ownership plan], or when businesses split up or are acquired, or when wealthy individuals want to gift property to an individual or organization,” he added. “Demand for one segment, though – reconstructing inventory or other business records following a natural or other disaster – has declined, thanks to more companies storing their data files in the cloud, instead of on local servers or using paper documents.”

Forensic audits are often triggered when a business owner “experiences unexplained variances in their cash flow, or if something appears off with the books,” according to Michael Saccomanno (<https://njbiz.com/2023-accounting-power-50-i-z/>), New Jersey partner-in-charge of Marcum (<https://www.marcumllp.com/>)’s Valuation, Forensic and Litigation Support Services group.



Saccomanno

There are also subtle but important differences between a traditional and a forensic audit. “It’s common for people to think of accounting audits as the most in-depth kind of engagement, but forensic audits go even deeper,” he said. “For one thing, we typically review all transactions during a forensic engagement, instead of a test sample that’s usually done during an accounting audit. We’re hunting for the nuts and bolts of where money came from, where it went, where it currently is.”

Saccomanno is seeing more activity, thanks in part to pandemic-era bailout funds. “Any time there’s more money available for things like PPP, or ERC, you’re going to see more fraud, too. That means more business for our forensics practice.”

Saccomanno also warned that any business that takes in cash payments – think of bars and, as credit card fees rise, more restaurants – may have more risk of being victimized by fraud or embezzlement.

“To reduce the chances of fraud, businesses need to implement internal controls,” he counseled. “For example, it’s a big red flag if the controller and the person who writes checks never take a vacation [enabling another employee to handle their duties, even temporarily], or does not let anyone else have access to the company’s books. Also, the person who receives cash should not be the same individual who records it in the books, deposits it, or writes the checks. And simply having a system of internal controls, or checks and balances, in place is not enough. You have to implement them, review and upgrade as needed, and ensure they’re being followed. At a recent engagement, a client told me their internal controls were adequate — but when we reviewed their operations, it turned out that the procedures were not being followed on a consistent basis and they were the victim of a fraud.”



Fitzhugh

Forensic professionals often have a traditional CPA background, “so we know how a business should work,” said Rebecca Fitzhugh, a principal at CliftonLarsonAllen (<https://www.claconnect.com/en>) – which recently acquired SobelCo – who focuses on forensic matters. “But there are different goals and, often, more freedom because there are no real guidelines – every step of the way we may be doing something different to track down money, investigate fraud, or dig into something else. And we often have to find evidence that may be presented in court.”

In one case, Fitzhugh and her team were called in when a New Jersey company that’s involved with entertainment thought something was going on backstage. “An individual in the organization was in charge of entertainment venues – the person could book acts, and had a corporate debit card. But during the pandemic, when many activities were cancelled, the person’s expenses remained elevated.”

The SobelCo professionals investigated and determined that the employee “was circumventing internal controls and, while supposedly sending payments totaling several hundred thousand dollars to vendors, the employee was actually making the payments to their own accounts. The

person was questioned by company officials but blew them off; and the matter was recently referred to law enforcement.”

‘Show-me’ professionals

Forensic accountants “tend to approach an engagement with a greater degree of skepticism,” compared to traditional audit or attestation engagements, observed Matt McFillin, a partner in KPMG’s Forensic practice (<https://kpmg.com/xx/en/home/services/advisory/risk-consulting/forensic.html>). “We’re also a bit nosier, since we usually examine just about everyone’s emails and text messages — we need to discover what they were thinking and saying.”



McFillin

Text and emails sent and received over company equipment may be available to forensic auditors under employee release policies, and in other cases may be obtained under authority of the corporate or other attorneys who engage the accountants.

“We’ve experienced a big rise in cyber investigations and official corruption engagements,” McFillin noted. “A lot of that is because of more regulatory scrutiny, particularly under the FCPA [Foreign Corrupt Practices Act of 1977, which made it unlawful for certain classes of persons and entities to make payments to foreign government officials to assist in obtaining or retaining business]. Other growth areas include banks, which have to comply with KYC [Know Your Customer] requirements, disputes between companies, and SEC-driven review of suspected corporate earnings manipulation.”

To help with investigations, McFillin said his team is taking on more staff. But the new hires are not limited to CPAs. “We’re also taking on more data scientists who can help us sift through volumes of emails and other documents — some of which may be in paper format and need to be converted to electronic format for speedier searching,” he noted. “The next big development will be artificial intelligence, which will change just about everything. (<https://njbiz.com/as-accounting-firms-embrace-ai-should-humans-be-worried/>) Of course, as technology advances, fraudsters get better, so it’s always a game of catchup.”
