PacificCPE

COURSE

11801A

Investigating Complex Frauds and Financial Crimes

Financial fraud schemes are growing in sophistication, and forensic accountants need sharp investigative skills to keep pace. This chapter dives into the mechanics of complex fraud and financial crimes, helping CPAs and financial professionals recognize patterns, understand how schemes are structured, and build the analytical foundation needed to detect and document wrongdoing. Whether you work in litigation support, internal audit, or public accounting, this course strengthens your ability to identify fraud risks and respond with confidence.

CREDIT HOURS 2 | FIELD OF STUDY AUDITING | EXAM QUESTIONS 10

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LEARNING ASSIGNMENTS AND OBJECTIVES

Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Recall the characteristics of various complex frauds and financial crimes.

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Chapter 1: COMPLEX FRAUDS AND FINANCIAL CRIMES

Chapter Objective

After completing this chapter, you should be able to:

- Recall the characteristics of various complex frauds and financial crimes.

Perspectives By Robert Elias, Criminal Investigator, CPA, MBA

Growing up in a small coal mining town, I never thought I would be meeting with Attorney Generals of foreign countries, kicking down doors of drug dealers, tracing funds of terrorist groups and having felons make threats of harm. It so happens that a career in law enforcement and a specialty in forensic accounting might take you places that you never fathomed. From a young age, I was always interested in accounting and law. I studied accounting in college, not knowing where it would take me other than: I wanted to do something that combined business and law.

Upon graduation, I went to work for a Big 4 firm in their audit practice and obtained my CPA license. There I worked with persons I consider some of the smartest, hardest working people I have ever met; but for me, something felt missing. I then decided to apply to become a Special Agent with the United States Treasury Department/IRS-Criminal Investigations and was slated to begin my new career in September 2001. As I was packing for 6-month basic training at The Federal Law Enforcement Training Center, FLETC, I watched 9/11 unfold on TV. Little did I know the focus of my future employer and thus my life would change forever.

I transitioned from performing annual financial statement audits to learning how to shoot, handcuff, drive police cars and investigate alleged criminals. Throughout the next 20+ years, my accounting background was used in ways even my imagination could not have dreamed. When I talk with others and say I love my job, it is something I say proudly and without hesitation.

My investigations have taken me literally around the world and into the darkest corners of humankind, places I did not realize existed. There have been investigations of what may be viewed as mundane, like an unscrupulous tax return preparer one day, who seemingly turned narcotics trafficker the next. I've also examined the work of terrorist groups, human traffickers and corrupt elected officials, billion-dollar tax cheats, Ponzi scheme perpetrators, corporate fraudsters, people who prey on the disabled and groups who took advantage of the elderly, organized criminals and violent gangs. If the crime involves money, which encompasses the majority of crimes, my colleagues and I are there to address it.

Criminals are located in all corners of the world and thus so are the travels where my job has taken me. I have been to every inhabitable continent performing arrests, search warrants, law enforcement activities, and training other police forces and militaries to combat crime and stop terrorists.

As a Special Agent with a forensic accounting background, not only is the pen mightier than the sword but the spreadsheet is mightier than both. You get to use your forensic accounting background to stop criminals in their tracks by putting them in prison and returning their ill-gotten gains to their victims.

The same way there is no limit to your imagination when it comes to investigating criminals, there is no limit to where a career in forensic accounting can take you.

Former Congressman Pleads Guilty to Helping Charitable Entity with Ties to Terrorist Organization [1]

On July 7, 2010, Mark Deli Siljander, a former U.S. congressman from Michigan, pleaded guilty in federal court to obstruction of justice and to acting as an unregistered foreign agent for the Islamic American Relief Agency (IARA), a charity with ties to international terrorism.

IARA, headquartered in Khartoum, Sudan, was a charitable organization formed in 1985 to raise donations in the United States to assist Africa in times of famine. The charity was closed in 2004, after the U.S. Treasury Department alleged that IARA had provided financial support for Osama bin Laden, Al-Qaeda, and the Taliban. IARA had received support from USAID totaling $1.3 million for relief projects in Mali.

The indictment alleged that IARA engaged in transactions for the benefit of terrorists and conspired with the former congressman to convert stolen USAID funds into payment on behalf of the charity. Co-defendants included Abdel Azim El-Siddig, of Chicago, Illinois, a former IARA fund-raiser, and Mubarak Hamed, the former executive director of IARA.

News sources suggest that Siljander, El Siddig, and Hamed knew that IARA was part of a large international organization and agreed to conceal Siljander's efforts on IARA's behalf. To accomplish the concealment, El Siddig and Hamed transferred $75,000 of IARA's funds to Siljander through nonprofit entities.

This case was investigated by USAID's Office of Inspector General, the Federal Bureau of Investigation, and the Internal Revenue Service, and was prosecuted by the U.S. Attorney's Office and the National Security Division of the U.S. Department of Justice.

In this chapter and the following modules, the authors examine various tools and techniques for the detection and examination of sophisticated, complex, and sometimes, global frauds and financial crimes. These modules, along with the learning objectives, include the following:

- Module 1 revisits two major types of fraudsters: situational ("accidental") and predators, where predators are a central focus of this chapter. The objective of this module is for the reader to be able to describe and contrast situational from predator fraudsters.
- Module 2 drills down into a second key feature of complex frauds and financial crimes: most involve collusion across multiple individuals, organizations, and jurisdictions. The goal in this module is for readers to apply the tools and techniques associated with sophisticated collusive acts to case scenarios.
- Module 3 closely examines how fraudulent and corrupt organizations are dismantled through asset forfeiture and seizure. The objective is for readers to identify appropriate forfeiture and seizure approaches and use those approaches to combat complex frauds and financial crimes.
- Module 4 outlines various complex frauds and financial crimes, including organized crime, drug trafficking, terrorism financing, money laundering, RICO violations, conspiracy, USA Patriot Act, Bank Secrecy Act, mail fraud, wire fraud, the Foreign Corrupt Practices Act (FCPA), and the UK Bribery Act. The goal here is for the reader to apply possible violations of laws and regulations to case scenarios.
- Module 5 considers the U.S. banking system and its role in international money movement. The goal in this module is for readers to efficiently and effectively identify and follow money flows through the traditional monetary system.
- Module 6 examines the various tools and techniques often exploited by bad actors to move money clandestinely, including international movements, money services businesses, bulk cash smuggling, trade-based money laundering, shell companies, casinos, insurance, trusts, informal value transfer systems (e.g., Hawala), virtual money (e.g., Bitcoin), and cell phones. The goal in this module is for readers to follow money by applying the more sophisticated tools and techniques associated with money flow concealment.
- Module 7 examines other complex frauds, including tax evasion, bankruptcy fraud, and securities fraud. The objective is for readers to identify and examine these types of fraudulent acts when presented with case facts and circumstances.

MODULE 1: THE PREDATOR VERSUS THE SITUATIONAL FRAUDSTER

The common fraudster is usually depicted with the following characteristics: first-time offender, middle- aged, male, well-educated, married with children, trusted employee, in a position of responsibility, and possibly considered a "good citizen" through works in the community or through a church organization. This individual is often described as having some nonsharable problem, typically financial in nature or that the problem can be solved with money, which creates the perceived pressure. When aligned with opportunity and the ability to rationalize his or her actions,

the otherwise good citizen succumbs to pressure, develops one or more fraud schemes and misappropriates assets, materially misstates financial statements, or commits an act involving some form of corruption. This person might be characterized as the "situational fraudster."

In the original rendition of this profile, the term "accidental" fraudster was coined. This moniker reflected the sense that, in general, many first-time fraudsters were "good individuals who made a bad, or a series of bad, decision(s)." As such, one might say that the person accidentally became a fraudster. Some in the antifraud community argued that fraud is intentional, and thus, no fraud is an accident. As such, over time, the term for the typical first-time offender has gravitated from "accidental" to "situational."

Notwithstanding the fraud act, the situational fraudster is often a good, law-abiding person, who under normal circumstances would not contemplate theft, breaking important laws, or harming others. When discovered, family members, fellow employees, and other persons in the community are often surprised or even shocked by the alleged behavior of the perpetrator. Because many of these perpetrators are in positions of trust (which creates opportunity), well educated, and leadership-level employees, Edwin H. Sutherland, in 1939 described them as "white-collar criminals."

White-collar crime, as designated by Sutherland, is crime in the upper, white-collar class, which is composed of respectable or respected business and professional men (and now, almost as often as not, women). White-collar crime is also referred to as occupational fraud or economic crime. The white-collar criminal's actions are consistent with the notion of a trust violator, and the crime is typically associated with an abuse of power. Despite some shortcomings with this type of descriptive terminology, white-collar crime captures the essence of the type of perpetrator that one often finds at the heart of occupational fraud and abuse.

The fraud triangle was created with the situational fraudster in mind. The fraud triangle helps investigators to understand who might commit fraud and why. The notion of perceived pressure and opportunity and the development of a rationalization for the crime provides a profile, not only to help understand the typical situational fraudster but also to help identify meaningful, nonfinancial, sociological, and psychological red flags that can be used as part of the investigatory process to determine who perpetrated the identified occupational fraud or abuse.

On the other hand, what if the person has committed an act of fraud at a prior organization? A repeat offender is not a situational fraudster; he or she is better described as a predator. The predator seeks out organizations where they can start to scheme almost immediately upon being hired. At some point, many situational fraudsters, if not caught early on, move from behavior characterized by the description of a situational fraudster to that of a predator. Financial statement fraud perpetrators often appear to start as situational fraudsters or even as managers of earnings and, sooner or later, become predators.

Research by Hermanson et al., using data from nearly 2,800 fraud cases included in the Association of Certified Fraud Examiners' Report to the Nations database, identify unique characteristics of predator frauds. In the primary analysis, the authors find that "predator fraudsters are less likely to be in leadership positions, are less educated, and tend to target smaller companies, while appearing less likely to target public companies. Predator frauds are shorter, but more costly overall, and there is some evidence that predator frauds are more likely to involve asset misappropriation or corruption. The authors also present exploratory analyses of "possible predators," first-time offenders who strike the organization early in their tenure. Overall, the data suggest that predators and situational fraudsters are fundamentally different on several dimensions." [2]

Beyond the predator-type person who seeks to deliberately defraud organizations with seemingly little remorse, we also find individuals and organizations that have operational modus operandi where a complex fraud or financial crime is inherently part of their goals and objectives. Organizational crimes occur when public and private companies, nonprofits, and government entities; otherwise, legitimate and law-abiding organizations are involved in a pattern of criminal activity. Corporate violations include administrative violations that involve noncompliance with agency, regulatory, and legal requirements. In other cases, organizations are deliberately established with at least some nefarious purposes in mind. We often think about organized crime, drug trafficking, and terrorism financing for the more complex frauds and financial crimes involving organizations. Organized criminal activities often involve many individuals, organizations, shell companies, and cross-jurisdictional borders. Some of the crimes that are typically observed include conspiracy and RICO (Racketeer Influenced and Corrupt Organizations) Act violations, money laundering, and mail and wire fraud. With terrorism financing, illegal acts derived from the USA Patriot Act come into play.

The important point is that predators and organizations focused on criminal activities exist, and reference to these types of entities as predators helps us to better understand their activities and motives, and examine allegations of fraud and financial crimes. Typically, these types of entities are involved in complex frauds, corruption schemes, and financial crimes. Because their activities are far more deliberate from the outset than those of the situational fraudster, they are better organized, have more sophisticated concealment schemes, and are well-prepared to deal with auditors and other oversight mechanisms. The reality is that, in many cases, the fraud triangle may not apply to the predator. Nevertheless, the primary investigative approach that focuses on the elements of fraud and adheres to evidence-based decision making holds quite well. Examinations centered on the act (the complex fraud or financial crime), the concealment of the crime, and the conversion (the personal benefit derived by the perpetrator from his actions) will lead to the development of a solid case from which the judicial community may determine the best course of remediation. Complex frauds and financial crimes include the following: money laundering associated with organized criminal activities, terrorism financing, money flows associated with drug

trafficking, tax evasion, deliberate misrepresentation of an entity's financial performance, and deliberate bankruptcy misreporting. Violations arising from these schemes may include money laundering, corruption, tax fraud, financial statement fraud, conspiracy, and mail and wire fraud.

MODULE 2: COLLUSION AMONG MULTIPLE INDIVIDUALS, ORGANIZATIONS, OR JURISDICTIONS

A central element of complex frauds and financial crimes is that of collusion. Collusion may be among individuals within an organization, individuals across organizations, or among multiple organizations. Collusion often spans multiple jurisdictions, including local, state, federal, and international borders and related laws. The ACFE's Report to the Nations indicates that when collusion is involved, fraud loss dollar amounts increase dramatically. [3] The losses caused by individual predators can be substantial, but when those individuals work in concert with others, the damage can be devastating and far more pervasive.

Bishop et al. suggest that "relatively little is known about how collusive fraud differs from solo-offender fraud." [4] To begin to fill this gap in the literature, the authors' "exploratory study examines differences between collusive fraud and solo-offender fraud, focusing on characteristics of the leader (perpetrator), incident, and organization," using "survey data collected by the Association of Certified Fraud Examiners (ACFE) on worldwide fraud cases from 2002 to 2022. The results highlight a number of unique dimensions of collusive fraud, including that collusive fraud leaders are more likely to be younger males with close ties to customers or vendors and a wheeler-dealer attitude."

The primary concern when collusion is involved is that preventive internal controls are generally ineffective in preventing fraud and other financial crimes. The primary internal control of segregation of duties helps to ensure that no individual controls every aspect of a transaction and separates the custody, recording, and approval functions. Detective internal controls include independent checks on performance and assurance of compliance with applicable laws and regulations. While internal controls cannot prevent collusive fraud and financial crimes, some may remain unaffected by collusion and assist in the detection of such activities. In particular, independent monitoring may reveal that internal controls have been circumvented through collusion.

If the predators are organized around criminal activities, however, it is unlikely that monitoring will have any impact because part of the goals and objectives of an illicit organization is to disguise the nature of its real operations from outsiders, including auditors, regulators, and law enforcement. Persons inside the organization, across organizations, and across jurisdictions act in such a manner so that the true underlying nature of the organization and its activities cannot be discovered.

Mixing Legitimate and Illegal Activities

Another element of complex frauds and financial crimes is that the perpetrators often mix legitimate business activities with their unlawful transactions. Money laundering provides an excellent example of a complex financial crime that is designed to mix monies from some legitimate and legal activity with proceeds obtained through some illegal activity. Understanding the essence of complex frauds and financial crimes requires attention to the definition of "the organization." Using the crime of money laundering as an example, assume that a local neighborhood tavern is used as a conduit for this activity. The operations of the tavern may be completely legitimate, except for the money laundering activity. The tavern is also part of a greater organization in which other individuals and/or entities are transacting illegal business activities that generate illicit cash proceeds. This cash needs to be "laundered" to appear legitimate.

To understand the motivation of the tavern's owner, we refer to the M.I.C.E acronym: the motivation could be money, ideology, coercion, or ego/entitlement. While it is unlikely that the tavern owner would get involved in an illegal money laundering operation to satiate his ego, he or she may be willing to play a role to obtain a "piece of the action" (money), to further a cause in which they believe (e.g., to fund terrorist operations) or because they are being threatened (coerced). Examples of coercion could be threats of physical harm to the owner, patrons of the tavern, the owner's family, or the physical premises of the tavern. Examiners must also have some sense of the entire story: who, what, when, where, how, and why (if known). To attempt to prosecute the tavern owner without a sense of the greater story will be far more difficult because the examiner will be unable to communicate that understanding to prosecutors, defense attorneys, judges, and jurors. To tell a more complete story, fraud and forensic accounting professionals must know the greater "organization," even if the organization is not recognized as a legal entity. Link charts are a graphical tool that may help an examiner to understand and communicate these often complex relationships (linkages) among people and "entities." Further, flow diagrams can be helpful to present the complex flow of transactions between and through the various parties.

The Need to Isolate Illegal Activities

Inherently, most complex fraud and financial crimes include a mixture of legitimate and illicit activities. One of the main challenges for examiners is to isolate the illicit from the legitimate activities. This is an essential element for successful prosecution of the crime and can be accomplished by using various examination tools and techniques. Many standard tools and techniques used for detection and examination are also used for these more complex crimes and illegal acts. In some cases, the analysis may be more complicated, but typically that does not lessen the benefit of applying standard tools and techniques.

MODULE 3: DISMANTLING ORGANIZATIONS USING ASSET FORFEITURE AND SEIZURE

Asset forfeiture or seizure is an important part of the process of dismantling an organization, particularly with complex frauds or financial crimes. As discussed above, the nature of these