

Criminal Justice, Law Enforcement and Corrections

PETTER GOTTSCHALK
EDITOR



Private Investigations

Suspicion of Financial Crime by White-Collar Criminals

NOVA

CRIMINAL JUSTICE, LAW ENFORCEMENT AND CORRECTIONS

PRIVATE INVESTIGATIONS
SUSPICION OF FINANCIAL CRIME
BY WHITE-COLLAR CRIMINALS

PETTER GOTTSCHALK

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FROM A DECLARATION OF PARTICIPANTS JOINTLY ADOPTED BY A COMMITTEE OF THE AMERICAN BAR ASSOCIATION AND A COMMITTEE OF PUBLISHERS.

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INTRODUCTION

This book is concerned with private investigations into suspicions of financial crime committed by white-collar criminals. Financial crime is illegal possession of others property, it is crime directed towards values of others for personal or organizational advantage, which is carried out by non-physical means and by manipulating and hiding criminal activities within regular business activities. It is with purpose, it is a break of trust, and it causes loss. White-collar criminals are persons who carry out financial crime in the context of their profession. It is individuals who enjoy respect and trust, they have a high social status in society, they occupy important positions in organizations, and they abuse trust and position as offenders. Their financial crime is hidden among legal financial transactions.

This book is about financial crime specialists and fraud examiners who conduct private inquiries into suspicion of white-collar crime. A private investigation is conducted by a variety of private sector financial crime specialists who can be detectives, forensic accountants, psychologists, or lawyers, all of whom may be supported by investigative analysts.

This book applies a perspective where research, study, investigation, inquiry and analysis are important to find the truth and its causes in a case. Therefore, this book is more influenced by police science and detective work, rather than laws and legal thinking. It is the private detective rather than the firm lawyer who is a potentially successful fraud examiner when it comes to abuse of power and suspicion of financial crime by the elite in society. But most of all is successful investigation characterized by a multifaceted and multidisciplinary work, including accountants, auditors, lawyers, organizational experts, forensic scientists and detectives. Their knowledge exchange and collaboration is needed to solve each financial crime case, which is like a puzzle. If one piece is missing, the puzzle will never be complete.

One of the unique features of this book is that it presents a number of examples of investigations in the private sector, which have been exposed in the media. Presented examples are concerned with investigations into suspicions of financial crime committed by white-collar individuals. Many cases have ended with jail sentences for white-collar criminals after the police got interested in the suspects.

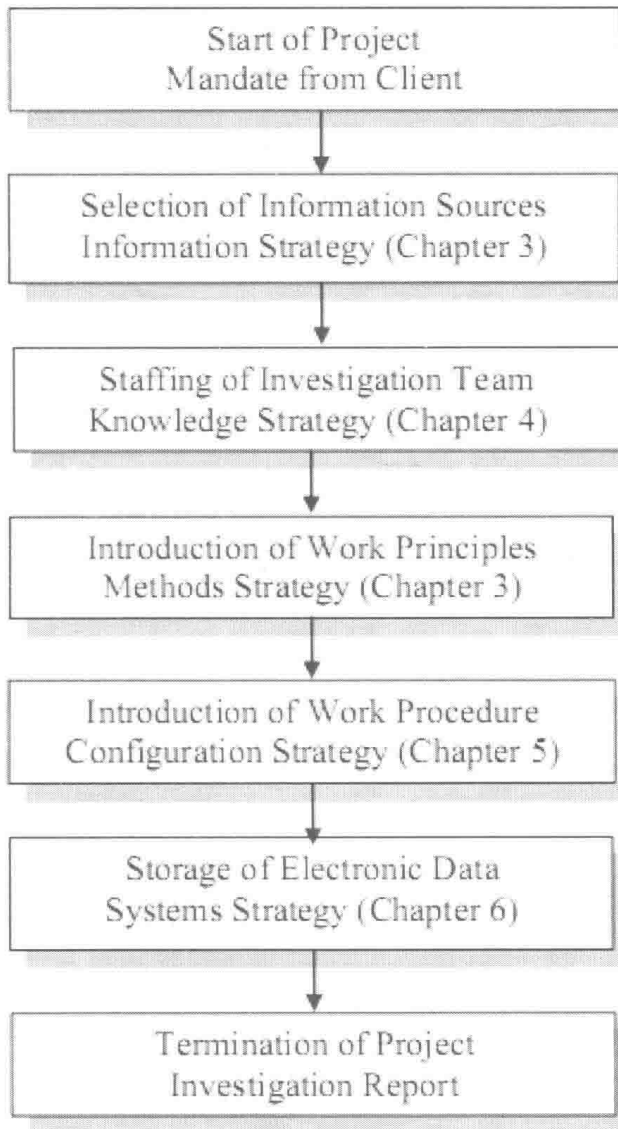
Another unique feature of this book is the policing and detective perspective, rather than the legal or auditing perspectives. This means that information sources and investigative methods are at the core of this book. An example of an information source is people, where the accompanying method is how you get information out of individuals, such as by interviews.

Thirdly, this book applies a project perspective on private investigations, where an investigation is carried out as a project. A project has a defined start and a defined stop, it has a mandate, and it has limited allocated resources.

Last but not least, this book applies a strategic perspective to private investigations, where choice of strategy is the selected path to reach a goal. Strategic investigation is about selection of strategic direction within the following five areas for financial crime specialists and fraud examiners:

1. *Information strategy*: What sources of information are available to financial crime specialists and fraud examiners? What sources are most valuable? How might information be trusted? What information is missing? How do we make sense of information? How is information quality in terms of content, time and form?
2. *Knowledge strategy*: What knowledge categories and knowledge levels are needed to succeed in this investigation? How is knowledge sharing, knowledge integration and knowledge creation organized? What kind of culture is created among knowledge workers?
3. *Methods strategy*: What approaches and procedures are followed to obtain relevant information, combine core knowledge and perform analysis of potential evidence? How are people interviewed? How are documents analyzed? How are intelligent search agents applied in computer systems? How are forensic evidence collected, stored and retrieved?
4. *Configuration strategy*: How is the value shop configuration applied to this investigation? What is done to understand potential suspicion of possible financial crime in terms of a problem diagnosis in the first primary activity of the value shop? How do we iterate in the value shop to gain new insights by applying new methods?

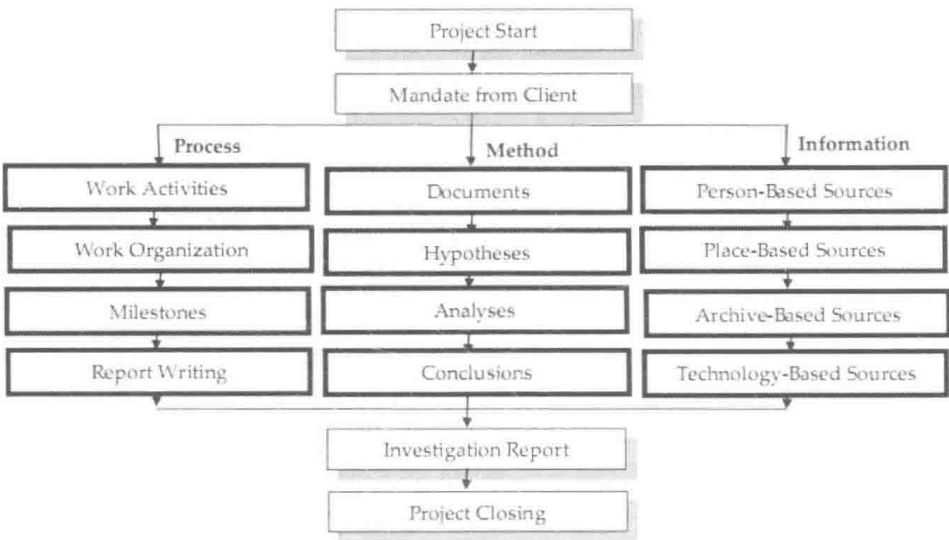
5. *Systems strategy*: What information systems are needed to access relevant data for this investigation? What information systems are needed to document this investigation? To what extent are person-to-tools systems, person-to-person systems, person-to-information systems and person-to-application systems required to succeed in this investigation?



Steps in Strategic Investigation Based on Suspicion of Financial Crime.

These strategies are described in chapters 3, 4, 5 and 6 in this book. Investigation as a project can follow a procedure as illustrated in the figure.

Project start is based on a mandate from the internal or external client, resource availability in terms of financial assets and human competence, initial schedule for examination activities, communicated expectations, identification of critical issues, and information about the project to stakeholders and involved persons. Then work is carried out to identify important information sources, which might be documents, persons, places and information technology.



Three Parallel Paths in the Investigation Project of Possible Financial Crime.

The investigation team is staffed with relevant and available experts based on criteria such as competence and representation. Work procedures are introduced in terms of methods strategy and value shop configuration. Collected information is stored in electronic systems, and information technology software is applied to analyze information. The project concludes and closes when the investigation report is handed over to the client and all clarity questions have been answered. This is illustrated in the figure.

Strategic investigation can have three parallel paths as illustrated in the next figure.

The process path defines work activities to be carried out, how the work is organized, what milestones are to be reached, and how the final report is to be written. The method path defines documents as sources of raw material for

hypotheses, analyses and conclusions. The information path includes all sources of information based on individuals, places, archives, and technologies. Sequence of steps in each path may vary, and so may interrelationships between paths as well be dependent on the situation to be examined. For example, archives with accounting and meeting reports might be studied in advance of interviews with individuals in the organization.

An inquiry is any process that has the aim of augmenting knowledge, resolving doubt, or solving a problem. An inquiry may consist of three faces: abduction, deduction and induction. Abduction is information used to generate a likely hypothesis or an initial diagnosis of the possible crime. Deduction is information used to clarify, to derive, and to explicate the relevant consequences of the selected hypothesis. Induction is used to test the sum of the assumptions against the sum of the data.

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Chapter 1

PRIVATE INVESTIGATIONS OF CRIME

When an organization wants to investigate facts, causes and responsibilities for an incident, the investigation can be carried out by financial crime specialists and fraud examiners. Fraud examination has elements of intelligence, investigation as well as analysis, like we know it from police work. Characteristics of inquiries where the term fraud examination is used include fact finding, causality study, change proposals and suspect identification.

Fraud examination as intelligence emphasizes the systematic and goal-oriented collection of information that is transformed and analyzed according to a rigid procedure to detect suspects' capacity, dispositions and intentions. The purpose is to improve both prevention and detection of crime. Risk-based techniques can be applied to survey environments and persons in order to collect information on their moves. Intelligence can also be defined as the result of information collection about possible offenses and potential suspects to make conclusions about threats, point out problems and identify criminal activity with an intention to follow the case.

Fraud examination as investigation is systematic and goal-oriented collection of information to confirm or disconfirm that an action is crime and that the actor is a criminal. Investigation is to prepare evidence for court proceedings. An investigation occurs only when something wrong has happened, while intelligence occurs when something wrong might happen.

Fraud examination as analysis is the process of breaking down a complex material or subject into smaller pieces to improve understanding and insight into the case. Analysis is to create meaning based on data by manipulating, interpreting and reorganizing the structure of collected evidence. To analyze is to ask questions such as what, where, how, who, when, and why. What

happened? How did it happen? Why did it happen? Elements of know-what, know-how and know why are created through analysis.

While fraud examination has elements of intelligence, investigation and analysis as we know it from police work, it is something different. For intelligence, something might happen. For investigation, something has happened. For analysis, evidence is to be produced. In fraud examinations, something might happen or something has happened. Fraud examiners do not know when they start their work.

Wikipedia applies the following definition of a private investigator:

A private investigator (often abbreviated to PI and informally called a private eye), a private detective or inquiry agent, is a person who can be hired by individuals or groups to undertake investigatory law services. Private detectives/investigators often work for attorneys in civil cases. A handful of very skilled private detectives/investigators work with defense attorneys on capital punishment and criminal defense cases. Many work for insurance companies to investigate suspicious claims. Before the advent of no-fault divorce, many private investigators were hired to search out evidence of adultery or other conduct within marriage to establish grounds for a divorce. Despite the lack of legal necessity for such evidence in many jurisdictions, according to press reports collecting evidence of adultery or other "bad behavior" by spouses and partners is still one of the most profitable activities investigators undertake, as the stakes being fought over now are child custody, alimony, or marital property disputes.

Private investigators can also be used to perform due diligence for an investor who may be considering investing money with an investment group, fund manager or other high-risk business or investment venture. This could serve to help the prospective investor avoid being the victim of a fraud or Ponzi scheme. By hiring a licensed and experienced investigator, they could unearth information that the investment is risky and or that the investor has suspicious red flags in his or her background. This is called investigative due diligence, and is becoming much more prevalent in the 21st century with the public reports of large-scale Ponzi schemes and fraudulent investment vehicles such as Madoff, Stanford, Petters, Rothstein and the hundreds of others reported by the SEC and other law-enforcement agencies.

FINANCIAL CRIME SPECIALISTS

In the UK, the Association of Certified Financial Crime Specialists (ACFS) was created to respond to a growing need for documented, verifiable and certifiable knowledge and skill in the financial crime field and to meet the career development needs of the diverse and growing number of specialists in the private and public sectors who work in this field.

A private investigation is conducted by a variety of private sector financial crime specialists who can be investigators, forensic accountants, or lawyers, all whom may be supported by investigative analysts, who the government usually calls intelligence analysts.

ACFS stresses the importance of the following topics for financial crime specialists:

1. The challenge of financial crime
2. Financial crime overview, commonalities and convergence
3. Money laundering
4. Understanding and preventing fraud
5. Global anti-corruption compliance and enforcement
6. Tax evasion and enforcement
7. Asset recovery
8. Financial crime investigations
9. Interpreting financial documents
10. Money and commodities flow
11. Compliance programs and controls
12. Data security and privacy
13. Ethical responsibility and best practices
14. International agreements and standards

FRAUD EXAMINERS

In the US, the Association of Certified Fraud Examiners (ACFE) was created for similar reasons as the ACFS in the UK. Becoming a certified fraud examiner requires documented academic and professional qualifications. Formal education in the fraud examination field is new and limited (Wells, 2003). The ACFE website (www.acfe.com) addresses the needs of ACFE members and also provides free resources to general public (Anders, 2006).

Certified fraud examiners have ample career opportunities, since the CFE certification was created in response to the demand for expertise in fraud prevention and detection (Morgan and Nix, 2003).

Perhaps Debbie Cutler was born to be a fraud examiner (Wells, 2003: 77):

“When I was young, my family referred to me as Perry Mason,” she said. “I was a very inquisitive child who wouldn’t give up until I got the answers.” It was happenstance that led her to combine her natural talents with her accounting degree. “I’d spent 10 years in public accounting performing traditional audit work,” Cutler said. “One day a partner invited me to help investigate an accounting malpractice case that included fraud allegations against a U.S. senator. I jumped at the chance, and as it turned out, I loved the work.”

Fraud examiners in the US can have varying backgrounds. It is not only lawyers, auditors and consultants who work as private investigators. Sociologists and criminologists can also take on tasks as detectives. Examples are mentioned by Kennedy (2013), who writes about forensic sociology and criminology. Investigation by sociologists and criminologists might be concerned about people who have neglected responsibility, people who have abused their positions, or organizations where training and guidelines have been missing.

Thus, fraud examiners encompass a wide array of professions, including auditors, accountants, fraud investigators, loss prevention specialists, attorneys, educators, sociologists and criminologists. While fraud examiners in the US can work independent, many are also member of the ACFE. Fraud examiners provide a broad range of services to businesses and governmental agencies as either employees or independent consultants (ACFE, 2008). A fraud examiner may assist in a fraud investigation by procuring evidence, taking statements, and writing reports (Machen and Richards, 2004).

When hiring a fraud examiner, a company should seek an evaluation that is both disinterested and reliable (Machen and Richards, 2004: 68):

These objectives, however, can occasionally conflict. Where employees within the organization conduct the fraud investigation, the results of such an investigation may be considered suspect because they are obtained by parties who are or at least appear to be biased. Thus, while the company may prefer to use examiners with historical knowledge and details about the company, personnel, and accounting systems, their retention may raise issues of credibility. On the other hand,

while the investigation of a fraud examiner who has no prior connection with the company may be unbiased, the resulting evaluation may also exhibit the examiner's inexperience with the particular organization and its business practices.

In balancing the twin goals of disinterestedness and reliability, Machen and Richards (2004) suggest that a company should consider the purpose of the investigation. Where the results are to be used in-house or where the company is simply establishing a fraud prevention system, there is less concern regarding credibility. Thus, a fraud examiner who has knowledge of the business may be a wiser choice in that instance because of such examiner's familiarity with the company. In contrast, where information from the fraud investigation may be subject to scrutiny by those outside the company, the appearance of disinterestedness becomes more critical and the company should consider hiring an independent fraud examiner.

Within the broad category of fraud examiners are forensic accountants who specialize in a unique brand of accounting that departs from the traditional methods employed in the accounting field (Machen and Richards, 2004).

PERSON-ORIENTED INVESTIGATION

Traditionally, crime suspicion is handled by talking to people who may have some relevant information. This approach is called person-oriented investigation, where suspects and witnesses are interviewed.

Financial crime investigators take testimony of witnesses. Testimony may explain records and transactions, clarify relationships, identify leads, and establish organizational structures. Records and documents do not speak for themselves and are often created to mislead. Interviewing skills are critical.

Informants usually request anonymity, which may make their information inadmissible, but a source of excellent leads and intelligence.

PLACE-ORIENTED INVESTIGATIONS

Forensic accountants may perform a variety of fieldwork such as inspecting company facilities to investigate whether goods and equipment are in accordance with company records (Machen and Richards, 2004).

There are almost no limits to the evidence that can be obtained by a well-drafted and properly executed search on relevant sites. The seizure may be financial information, videotapes, transaction records, and many other things.

ARCHIVE-ORIENTED INVESTIGATION

Forensic accounting is the application of financial skills and investigative mentality to unresolved issues, conducted within the context of the rules of evidence. As a method, it encompasses financial expertise, fraud knowledge and a strong knowledge and understanding of business reality and the working of the legal system. Expertise as part of the method represents skillful execution of knowledge and skill to achieve effective investigation results (Taylor et al., 2013). Forensic accountants turn traditional accounting principles on their head by questioning and investigating the accounting methods and financial practices of a company (Machen and Richards, 2004: 68):

Unlike traditional accountants who assume honesty and integrity in the examination of a corporation's finances, a forensic accountant typically will question figures and numbers until they are validated. For example, while the traditional accountant may examine a company's records to determine whether they are accurate, the forensic accountant will search for badges of fraud in financial statements, balance sheets, and underlying corporate documents. Furthermore, as part of their investigations, forensic accountants may perform a variety of fieldwork from inspecting company facilities to participating in witness interviews. Accordingly, a forensic accountant may be useful not just in assisting an organization create a fraud prevention program, but may also detect and identify instances and responsible parties once the organization has determined that fraud has in fact occurred.

A financial crime specialist needs to interpret and handle financial documents as if they will be used in a legal case. During the investigation it may be hard to know what will be relevant, so all documents must be treated with an assumed degree of relevance. For the financial crime investigator, financial statements are viewed as a source of leads to specific financial transactions that could form the basis of violations of criminal and civil law and regulations. The financial specialist's job is to discover the story behind

the numbers. Chain of custody procedures includes a documented chronology of the handling of the document or physical evidence. Important chain of custody documentation may include where the item was initially located, who collected it, where it was filed, and documentation of each person who handled it.

TECHNOLOGY-ORIENTED INVESTIGATION

One method of detecting improper activities in corporations where financial crime is suspected is through the use of information technology. Most organizational information is usually created and managed electronically. Computer forensics allows private investigators to uncover more of the facts, support otherwise unsubstantiated information, confirm or refute allegations, and analyze competing theories in relation to those facts. Computer forensics involves identifying, collecting, analyzing, and protecting large amounts of data and peripheral evidence (Newman, 2009).

Computer forensics is defined as a scientific, systematic inspection of the computer system and its contents for evidence or supportive evidence of a crime or other computer use that is being inspected. It includes the art and science of applying computer systems to aid the inquiry process. Additionally, analytical and investigative techniques are used to examine this evidence and data that is magnetically stored or encoded using the binary number system. The computer might have been the target of some illegal activity, the medium through which the illegal activity is committed, incidental to the commission of the illegal activity, or a combination of the previous three (Newman, 2009).

Data mining is about extracting information from large data bases (Srinivasa et al., 2007, s. 4295):

Data mining is a process of extracting nontrivial, valid, novel and useful information from large databases. Hence, data mining can be viewed as a kind of search for meaningful patterns or rules from a large search space that is the database.

Forensic ToolKit tells about their products in this way (<http://www.accessdata.com/products/digital-forensics/ftk>):

FTK is a court-accepted digital investigations platform built for speed, stability and ease of use. It provides comprehensive processing and

indexing up front, so filtering and searching is faster than with any other product. This means you can zero in on the relevant evidence quickly, dramatically increasing your analysis speed. The database-driven, enterprise-class architecture allows you to handle massive data sets, as it provides stability and processing speeds not possible with other tools. Furthermore, because of this architecture, FTK can be upgraded easily to expand distributed processing and incorporate web-based case management and collaborative analysis.

Some caution is needed before getting too excited about data mining, according to Lind et al. (2007):

Whenever huge masses of personal data are stored at one place, and especially when tied to a system with the intelligence to tailor this data, there is enormous privacy risk. The idea is that strict access control surrounds the data. Will that be the case? We can only hope. We see a risk of abuse from corrupted personnel and from hackers or other intruders. Also, there is a risk that data be overly interpreted as true, and that end users be wrongly accused. With the ease in accessing and perhaps performing data mining on huge amounts of personal data, the risk that a police investigation might take the wrong turn is much greater.

HYPOTHESES TESTING

Theory enables private investigators to create an overview over complexities in the real world by offering a verbal tool to organize a common and consistent understanding of reality (Colquitt og Zapata-Phelan, 2007):

A theory might be a prediction or explanation, a set of interrelated constructs, definitions, and propositions that presents a systematic view of phenomena by specifying relations among variables, with the purpose of explaining natural phenomena. The systematic view might be an argument, a discussion, or a rationale, and it helps to explain or predict phenomena that occur in the world. Some define theory in terms of relationships between independent and dependent variables, where theory is a collection of assertions, both verbal and symbolic, that identifies what variables are important and for what reasons, and that specifies how they are interrelated and why. It identifies the conditions under which