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The Case of the Frequent Flyer Fraudster

ABSTRACT

This case, based on a real fraud, engages students in a fraud investigation learning activity with a focus on interrogation. Students analyze an interrogation, identify and discuss verbal and nonverbal cues to deception, discuss legal ramifications of conducting fraud examinations, and develop recommendations to improve internal controls. The intended audience is a fraud examination course.

Key Words: fraud examination, interrogation, internal controls, interview techniques

1. The audit begins

It was a late summer evening at the home office of DCR Foods. Internal auditor Joe “Hawk” Doyle was completing the testing of expense reports submitted by employees of the International Sales Division. Since the internal audit department had not reviewed expense reports for several years, Gina Caywood, Director of Internal Audit, put her best auditor on the assignment. Hawk had a reputation for being a relentless and thorough investigator. With roughly twenty years of audit experience under his belt, ten of those years at DCR Foods, he was a seasoned veteran. Hawk had investigated several fraud cases in the past, including some that resulted in convictions of the perpetrators.

A month earlier, Hawk had asked the Accounts Payable Department to compile a list of employees from the International Sales Division who had submitted expense reports during the past three years. The list was quite large, as the division employed over 100 sales representatives who travelled extensively domestically and abroad. Total travel expenses, including entertainment, for these sales representatives over the past year alone amounted to over \$10 million. Hawk did what most auditors would do in this situation; he stratified the population and judgmentally selected a sample of expense reports submitted by employees responsible for the largest dollar expenditures. In this case, roughly 30 percent of the sales representatives accounted for 70 percent of the total travel expenses.

DCR Foods provides international sales representatives corporate credit cards and an initial travel advance of \$20,000 to cover the cost of travel and entertainment until the sales representative is able to submit expenses for reimbursement. Sales representatives submit

expense reports with receipts each month with a request for reimbursement. The data submitted on the expense reports includes destination, purpose of trip, and amount charged by category (transportation, lodging, meals, other). The Director of International Sales, Jerry Howell, then reviews the reports and either approves or denies the expenses. Jerry sends the approved expense reports to Accounts Payable for payment. DCR reimburses sales representatives for approved expenses by transferring funds to the sales representatives' personal checking accounts. Credit card companies send bills directly to the sales representatives who are responsible for payment. As long as a sales representative submits expense reports on a timely basis, the funds will be available for him or her to pay the credit card company on time. In the event that the sales representative misses a credit card payment, the credit card company notifies DCR Foods (the guarantor of the bill) and requests payment. Sales representatives occasionally missed credit card payments because they were tardy in submitting an expense report. However, Accounts Payable reported that in each case the sales representative ultimately submitted an expense report and paid the credit card bill.

In order to test the expense reports, Hawk extracted expense report information from Accounts Payable data files and created a spreadsheet file. He sorted the charges by date, location, and type of expense by employee and then went about the painstaking process of comparing the supporting receipts to his file. The testing went relatively smoothly; however, there were some exceptions where sales representatives failed to submit receipts or recorded the wrong amount of the charge. These exceptions were minor in amount and did not arouse suspicion of fraud. As Hawk was about ready to call it a day, he noticed something odd about an

expense report submitted by a senior sales representative named John Smithe. It appeared that Smithe submitted a receipt for dinner in Los Angeles on the same day he reported being in Tokyo. For the next four hours, Hawk pored over Smithe's expense reports and found more discrepancies. It was now time to bring Gina up to speed on his findings.

Hawk called Gina with the news and suggested a game plan for how to proceed. The next step would be a thorough review of Smithe's credit card billing statements to determine if there were other irregularities. Since DCR was a guarantor of Smithe's credit card account, DCR requested and received copies of Smithe's credit card statements from the credit card company.

As Hawk suspected, there were other odd charges made by Smithe, and unexplained credits to his account as well. For example, in one case American Airlines charged Smithe \$5,740 for a trip to Singapore and Bangkok, followed by a credit for the same amount and an additional charge of \$4,850. This same pattern held true for several other international trips – two different charges by the airline for the same trip and a credit for the higher charge. Something was definitely wrong and Hawk started to develop a fraud hypothesis. The fraud scenario became clearer to Hawk after he analyzed details of the airline charges. The larger amounts were charges for business-class airfare and the smaller amounts were for coach airfare. Hawk formed a theory of the fraud: Smithe submitted receipts for business-class airfare for reimbursement, but actually flew and paid for coach airfare. After noting cases where Smithe's credit card account had an initial charge followed by a credit of equal amount and no additional charge, Hawk also theorized that in some cases Smith submitted receipts for trips he did not take.

2. Further investigation and interrogation

Armed with his findings, Hawk conferred with Gina and they decided to bring in the most skilled criminal investigator on the audit staff, Mike Esposito. Mike came up through the ranks in the Loss Prevention Department of DCR Foods and he was well-trained in the art of criminal investigation and interrogation. Hawk and Gina met with Mike to begin phase two of the investigation. Mike initially had three concerns. First, how long had the airfare scam been going on? Second, what other types of scams had Smithe been perpetrating? Recall, Smithe submitted meal receipts from restaurants in cities that he had not visited for business purposes. Third, were other employees involved? Additionally, Mike suggested a thorough review of Smithe's personnel file to determine if anything in his past might suggest a rationale for the theft. The game plan called for Hawk to further scrutinize Smithe's expense reports for the past ten years and for Mike to review Smithe's personnel file. Before doing so, Gina informed the company's legal counsel that an investigation was underway and that Smithe was the target.

After completing his data analysis procedures, Hawk estimated that Smithe had pocketed roughly \$250,000 from the airfare scam over the past ten years. Unexplained meal receipts amounted to another \$20,000 over that time. Hawk did not find any evidence that indicated other sales representatives had participated in the airfare scam and he did not identify any other significant unexplained expenditures. After reviewing personnel records, Mike found that Smithe was actually a long-time employee who had retired as a vice-president of sales; DCR

retained Smithe as a consultant due to Smithe's long-standing relationships with DCR's international customers.

Since there was no evidence that other employees had been stealing from the company, the audit team focused their investigation on Smithe. The next step in the investigation was for Mike to interrogate Smithe. Mike considered what approach to use with Smithe in the interrogation. A direct-accusation approach would be confrontational and in Mike's experience, would yield poorer results than a non-confrontational approach. Consequently, Mike decided it would be best to approach Smithe in a non-confrontational manner.

Mike made arrangements to meet with Smithe alone at DCR Foods' corporate office. Mike arranged the meeting room in advance so that there were two chairs facing each other with no obstacles between them, which allowed Mike to observe Smithe's non-verbal behavior. After brief introductions, Mike reminded Smithe that the meeting was voluntary and that he was free to leave at any time. For the next 30 minutes, Mike conducted the interrogation.

3. Requirements

Prepare a report to address the following requirements.

1. Watch the interrogation via the video link (The case video available on the Internet at: <http://youtu.be/AJDS6hQMI0A>). Identify the phases of the interrogation and what the interrogator was trying to accomplish in each phase.
2. What are some verbal and nonverbal cues to deception and why is an understanding of verbal and nonverbal cues important when interrogating a fraud suspect?

3. Summarize the investigation and provide recommendations to management that would improve internal controls over the expense report process.
4. Describe the difference between civil and criminal as it relates to fraud investigation.
5. In the event the case would go to trial, describe the rules of evidence and rights of the accused concerns as they apply to this case. What specifically should the auditors be concerned with?
6. Should management refer the case to the authorities? Explain why or why not.