Collusion in Fraud: Detection approaches

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About the Presenter

- **Yigal Rechtman is a CPA, CFE, CITP,** and **CISM** with professional experience in audit, accounting, and forensic and analytical work. His background includes applying analytical procedures in forensic accounting, audit planning, risk assessment, and review engagements, with a focus on translating auditing standards into practical, defensible audit documentation.
- Yigal works with audit teams on issues related to analytical procedures, professional judgment, and peer review readiness.
- He is the founder of **The CPA Publisher**, an initiative focused on practical, standards-based CPE designed for how audits and reviews are actually performed.

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Objectives

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1. **Review fraud triangle** and the fraud triangle's sub-triangles
2. **Review collusion**, and understand how it affects fraud or audit detection
3. **Understand how collusion is created**.
4. **Explore practical tips** for identifying collusion.

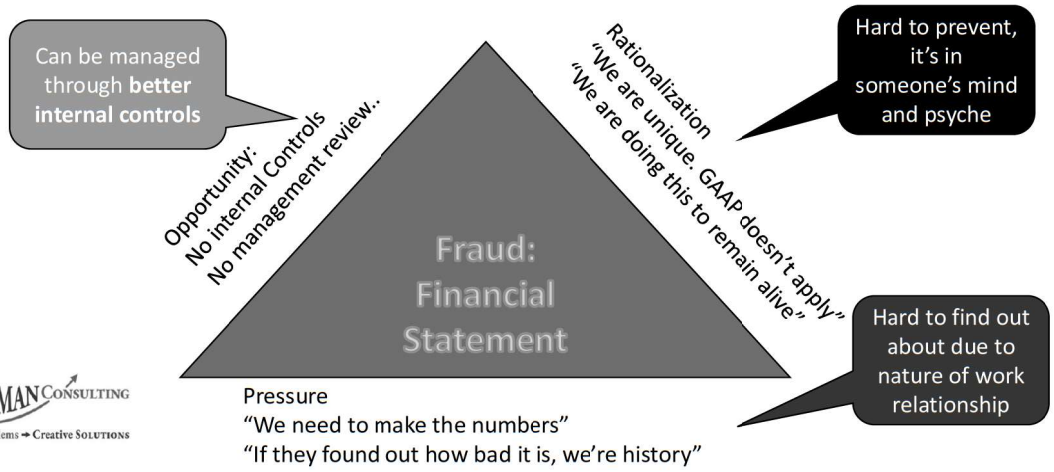
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Why Collusion is Hard to Detect

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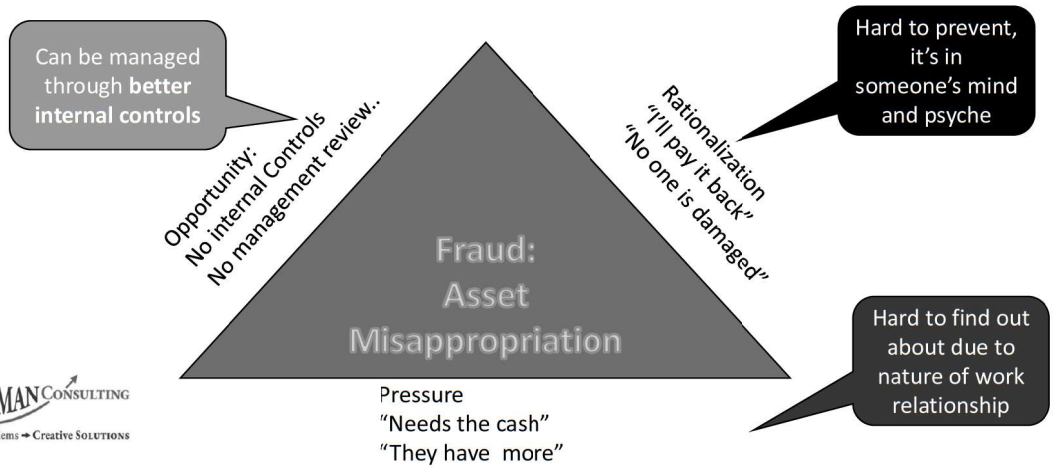
- The fraud triangle in **Financial Statement Fraud**:



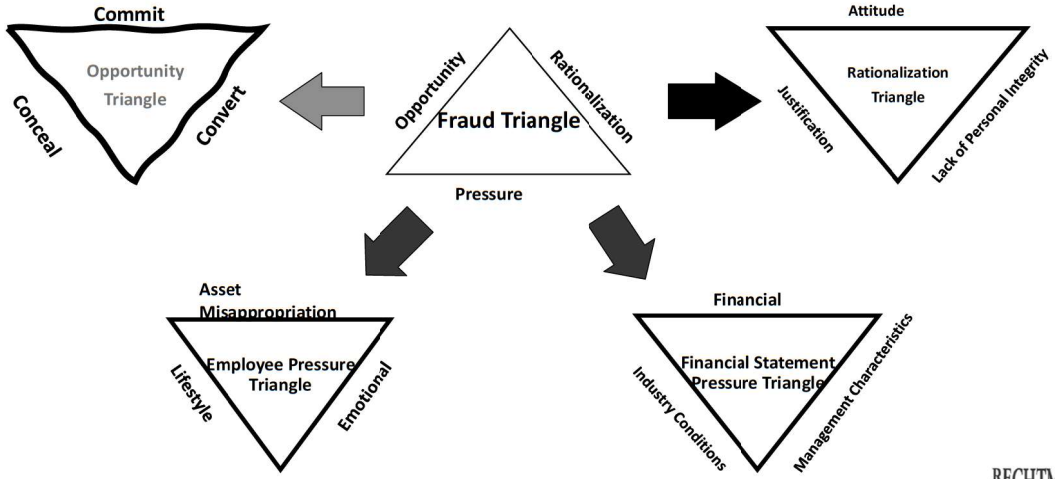
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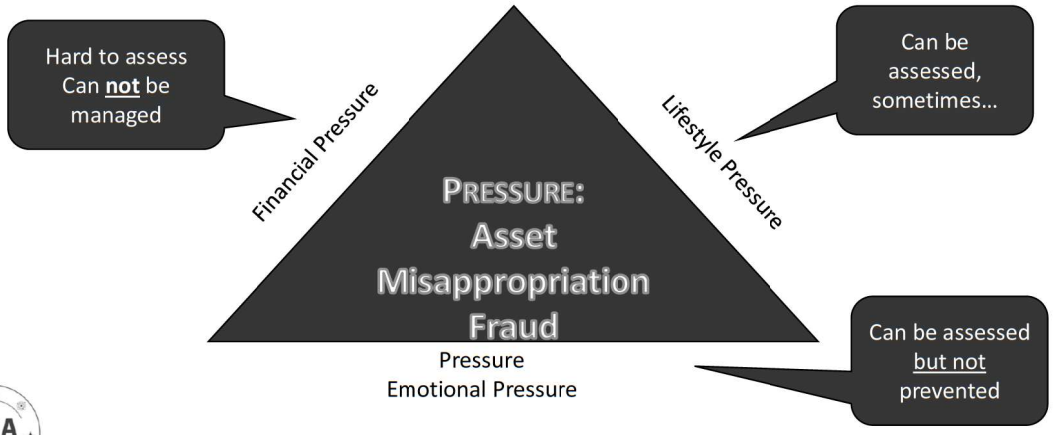
- The fraud triangle in **Asset Misappropriation Fraud**:



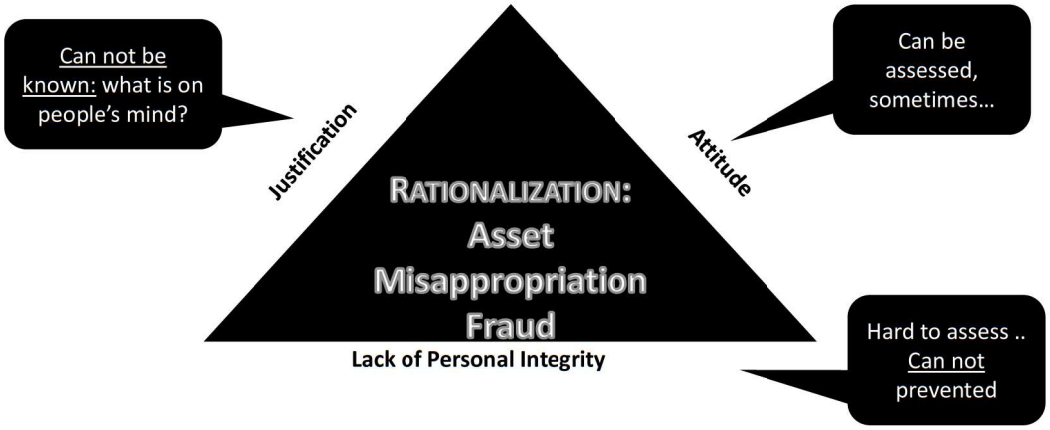
A word about Fraud (cont.)



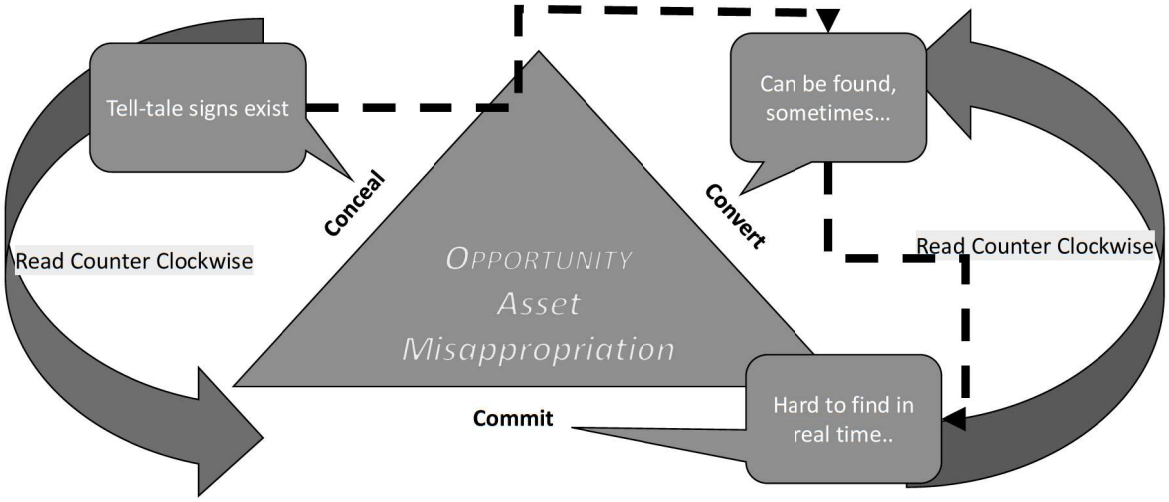
The sub-Triangle for each of the elements of Fraud



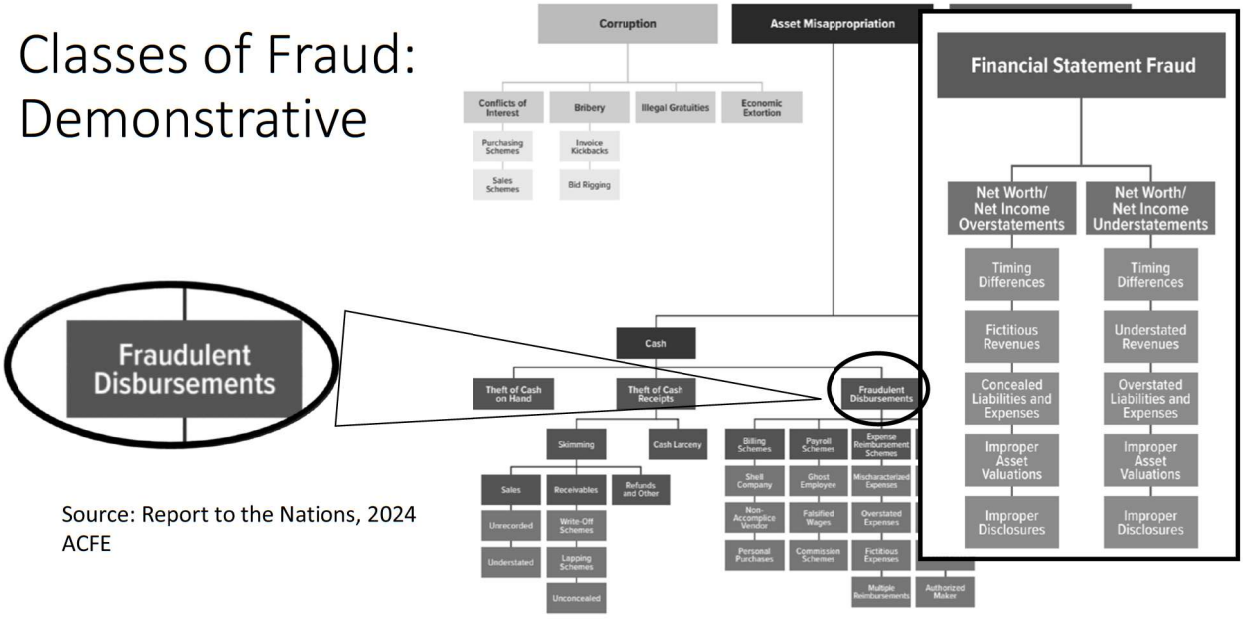
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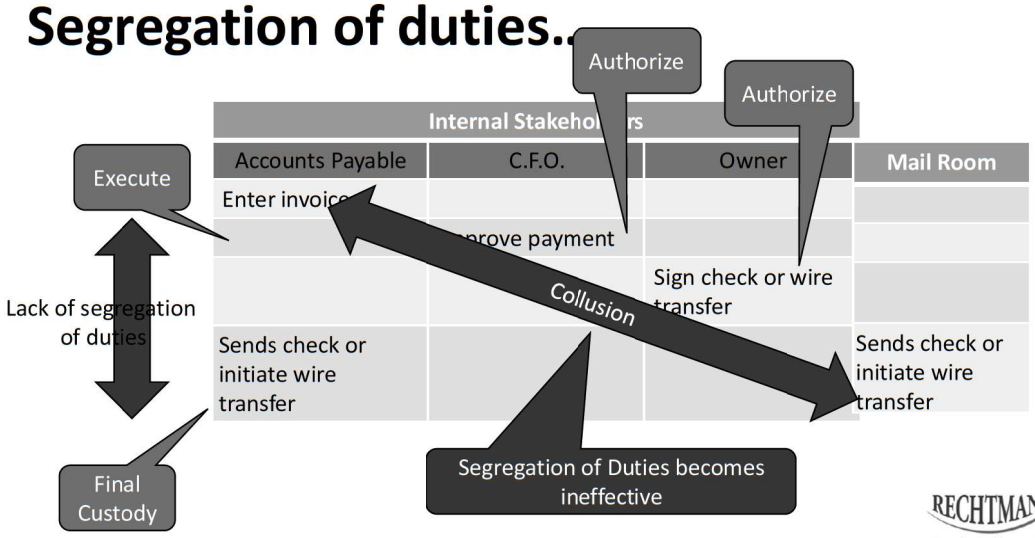


Classes of Fraud: Demonstrative



Source: Report to the Nations, 2024 ACFE

How do we manage internal Controls?
Segregation of duties..



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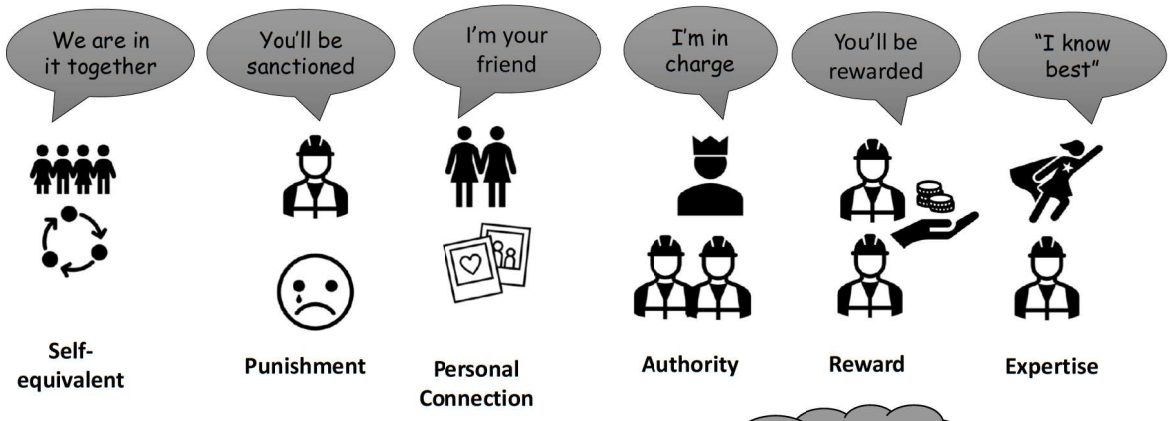
Collusion – Where are we now

- Audit Standards (AU 316.10) addresses collusion as a risk that auditors should be aware of in performing their risk analysis
- The challenge for auditors and fraud investigators is to imagine a situation where there are **good controls** which are **overpowered by collusion**:
- The ACFE 2024 *Report to the Nation* states that "cases involving collusion.. perpetrated by individuals at higher levels of authority also **have higher velocities and inflict financial damage to the victim more quickly**".
- The World Bank Group reported collusion 2023 levels of about 40% of *reported* cases. The ACFE puts the number at 54%.
- Asset misappropriation fraud involving collusion have the **mean loss of $250,000** for two perpetrators, and **$329,000 for three or more perpetrators**.

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Visualized types of Recruitment

Typically, a single person start a scheme and needs help from others.



S.P.P.A.R.E.

Remember...

Detecting Collusion

The **risk of collusion can be identified** when there is

Observation	Type of Recruitment
A **strong person** running a department	Expert Reward
High **reliance on financial managers**, and/or **Little financial involvement** by ownership [responsible = owner]	Authority Punishment
High concentration of **family members** or **People from a similar cultural** or national background	Self-Equivalent
Not detectable, except by others working together	Personal connection

Detection Protocols: Investigation vs. Audit

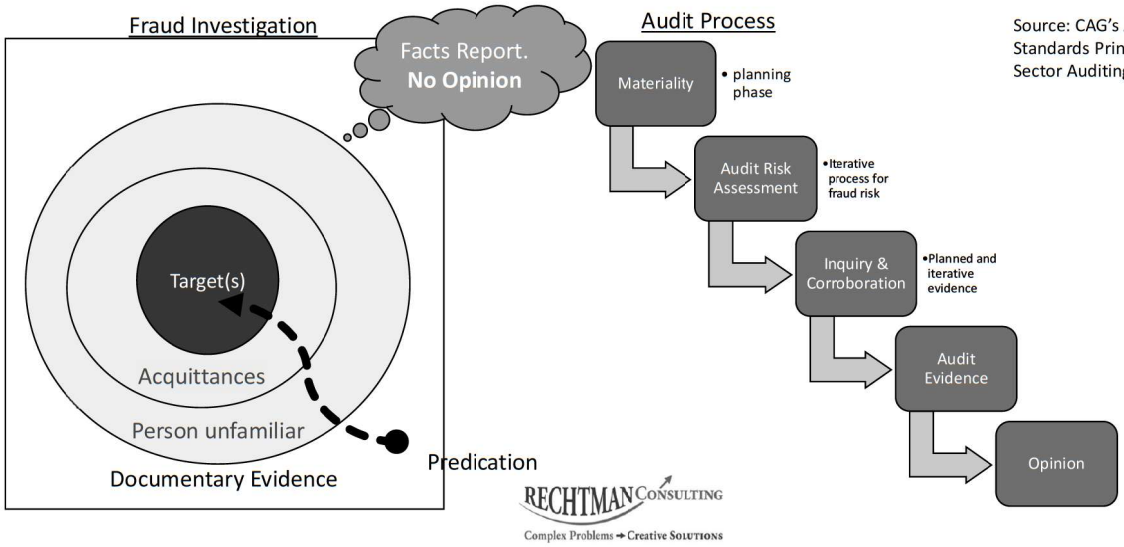
- Fraud investigation:
  - Objective: Outcome in terms of who/when/how much?
  - Prime reliance: interviews, documents, circumstances, time-line

- Audit:
  - Objective: Material misstatement
  - Prime reliance: Risk assessment, documentary evidence

Unscheduled Slide – what does collusion looks like – "Margin Call", the movie



Addressing Fraud: differing protocols



Source: CAG's Auditing Standards Principles of Public Sector Auditing (2.5)

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How to identify Fraud Collusion

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- **Fraud**:
  - Assess the risks of collusion:
    - "Strong (wo)man" at the top
    - Expert combined with low level of oversight
    - High degree of familial or cultural connections
    - Friendship (secondary and final interviewing phases)
- **Audit**:
    - Work backwards from inquiry to fraud risk
    - Allow and respond to informal observations from staff and client ("they are close friends", "X and Y are nephew and aunt")
    - Search for lack of tension among internal stakeholders

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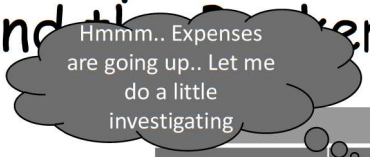
Breaking down Collusion: Fraud Investigation

- Objective: information and admission
- Process:
  - Always start with **Rationalization**: using the vocabulary and world view of the person being interviewed
  - **Validate** interviewee to **shift the blame to co-conspirators**
  - As always follow the **question-and-answer protocol**:
    - **Close ended** questions to establish rapport
    - **Calibrating questions** to establish truthfulness
    - **Open ended questions** to solicit information
    - **Close ended** questions to confirm information obtained
    - Secure cooperation for future needs

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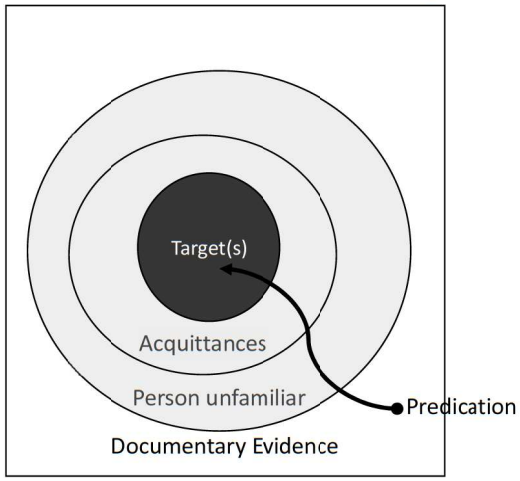
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Example: Accounts Payable, Mail Room, and [illegible] walk into a bar



Internal Stakeholders				External
Accounts Payable	Accounting Manager	Owner	Mail Room	Bank Clerk
Enter invoice Issue checks and wire forms		Cousins		
	Reviews payments			
		Sign check or wire transfer	Sends check or initiate wire transfer	Church
	Reconciles bank statement			Cash payroll checks for company

Example: after evidentiary red flag of checks were collected, interviews begins…



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Example: Interview with Accounting Manager

- **Opening** Close ended questions: How long have you worked? What reports do you prepare? Who sees your reconciliations?
- **Substance:** Open ended questions: Who runs the checks and wires? What can you tell me about the relationship between people in your department? How involved is the owner in the accounting process?
- **Concluding:** Close ended questions: [Confirm the answers to the above]
- Secure cooperation if more questions arise.

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Example: Interview with mail clerk

Questioning the mail-clerk first, **weakest possible link**:

Q. [*Close ended*] How many years have you worked here? What are your responsibilities? Who gives you the checks to be mailed?

Q. [*Open ended*] When do you go to the bank? If the bank has a strict rule, why would the banker allow you to cash check? How do you know the bankers? Who issues the check in the first place? Tell me about the process?

Why would your name appear on an endorsement?

Why would the address of this vendor the same as your home address?

Q. [Close ended] Confirm answers to above.

The checks were given to you from your cousin in accounts payable. S/He is the one who instructed you to go to your friend from Church to cash them.

S/He took most of the money, you only got $100 for each check, right?

Q. Secure cooperation.

Audit Requirements for fraud consideration

Fraud Considerations:

Did the auditor properly document compliance with fraud risk considerations? [AU-C sec. 240B.44] Documentation should summarize A132

- discussion among engagement personnel in planning the audit regarding the susceptibility of the entity's financial statements to material misstatement due to fraud, how management could perpetrate and conceal fraudulent financial reporting, and how assets of the entity could be misappropriated. [AU-C sec. 240B.15]
- documentation of inquiries of management, those charged with governance, and others within the entity about risks of fraud. [AU-C sec. 240B.17–.21]

Fun Fact: "Collusion" does not appear in the Peer Review Package for field work [20,400]

Source: **PRP §20,400** Copyright © 2021, American Institute of Certified Public Accountants, Inc.

Interview in an Audit: search for unknown, known connection

- Audit fraud risk is required under AU 316:

  "..inquiry of **additional members of management or others** may be helpful in identifying issues and corroborating other audit evidence" [AU 316.52]

What does this requirement mean?

- Multiple people should be interviewed about possible fraud.
- The nature of the interview should be to **seek possible connections that an auditor will not be able to observe:** friendship, familiarity, authority, etc.

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Audit: Interview "members of management or others"

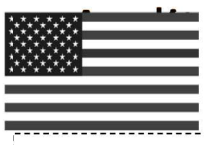
- Questions to include:
  - Who in the office / department are best friends?
  - Who touts themselves as an expert in what they do?
  - Who goes on vacation together?
  - Who give gifts to co-workers from their own money?
- Observe and Look for:
  - Who has best vehicles, best clothes, better vacations within the company?
  - Are client-employees reluctant to speak with audit one-on-one?
  - Is there a prevalence of blame-shifting among employees?

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Audit Response to Fraud: post-engagement

- Couch language that describes the limitation due to collusion. **Consult legal and insurance professionals** for specific guidance.
- Recommend **anonymous hotline** for companies to report **fraud-waste-abuse:**
  - Help clients find a service as an **advisory** capacity.
  - Establish hot-line entity for non-attest clients.
  - Recommend that client's attorney consider becoming a hot-line service as an additional service from law firm.
- **Train staff** to avoid check-list mentality. Encourage the sharing of "soft knowledge".

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Requirements for [illegible] consideration

Fun Fact: "Collusion" does not appear in the IACA Auditing Standards or in Standards by Comptroller and Auditor General of India



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Inquiry of Management and Others within the Entity (Ref: Para. 18)

A15. The auditor's inquiries of management may provide useful information concerning the risks of material misstatements in the financial statements resulting from employee fraud. However, such inquiries are unlikely to provide useful information regarding the risks of material misstatement in the financial statements resulting from management fraud. Making inquiries of others within the entity may provide individuals with an opportunity to convey information to the auditor that may not otherwise be communicated.

A16. Examples of others within the entity to whom the auditor may direct inquiries about the existence or suspicion of fraud include:

SA 240 18

Sources: **PRP §20,400** Copyright © 2021, American Institute of Certified Public Accountants, Inc.
SA 240* The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements ICAI.ORG

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Questions and Discussion

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