

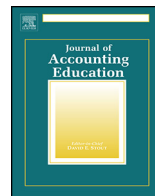


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Educational Case

The case of the frequent flyer fraudster[☆]



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ABSTRACT

This case, based on a real fraud, is a fraud investigation learning activity with a focus on interrogation. The case requires students to analyze a non-confrontational interrogation, identify and discuss verbal and nonverbal cues to deception, discuss legal ramifications of conducting fraud examinations, and identify and address internal control weaknesses.

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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 of DCR Foods. 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 20 years of audit experience under his belt, 10 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, all of whom 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

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expense reports submitted by employees responsible for the largest dollar expenditures. In the case at hand, roughly 30 percent of the sales representatives accounted for 70 percent of the total travel expenses.

DCR Foods provides international sales reps corporate credit cards and an initial travel advance of \$20,000 to cover the cost of travel and entertainment until the sales rep is able to submit expenses for reimbursement. Sales reps submit expense reports with receipts each month with a request for reimbursement. The data submitted on the expense reports include 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 reps for approved expenses by transferring funds to the sales rep's personal checking account. Credit card companies send bills directly to the sales reps who are responsible for payment. As long as a sales rep 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 rep misses a credit card payment, the credit card company notifies DCR Foods (the guarantor of the bill) and requests payment. Sales reps occasionally miss credit card payments because they are tardy in submitting an expense report. However, Accounts Payable reports that in each such case in the past the sales rep ultimately submitted an expense report and paid the credit card bill.

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 the information in the file he created. The testing went relatively smoothly; however, there were some exceptions where sales reps 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 rep 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 \$5740 for a trip to Singapore and Bangkok, followed by a credit for the same amount and an additional charge of \$4850. 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 alleged airfare scam been going on? Second, what other types of scams might Smithe have been perpetrating? Recall, Smithe submitted meal receipts from restaurants in cities that he had not visited for business purposes. Third, were other employees involved?

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