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SOME ASPECTS OF FRAUD, CONTROL AND INVESTIGATION

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And the serpent said unto the woman, Ye shall not surely die: For God doth know that in the day ye eat thereof, then your eyes shall be opened, and ye shall be as gods, knowing good and evil. *Genesis* 3:6

Fraud is as old as the world. And so we find in our Biblical writings of the misrepresentation in the Garden of Eden, and the later deception of Isaac by Jacob with the connivance of his mother Rebekah in obtaining his father's blessing and the birthright of his brother Esau. The builder of the treasury of Rameses III is said by Herodotus to have provided a secret passage by which he might drain the treasure of his royal master. The Jews in bondage in Egypt devised means to defraud their captors of their jewels. Loaded dice have been found in ancient Herculaneum. Individuals practised fraud as a profession in ancient and medieval times. Throughout the ages men of glib tongue and lacking in moral sense have practised deception upon their fellows for their own personal advantage and gain, or being of otherwise good morals engaged in deceit to perpetrate a mischief or thinking to extricate themselves from financial stress.

All through history we find the evil of fraud and man trying to protect himself against the swindler, the liar, and the cheat with negligible success. In ancient times frauds were the concern of the individual, to be settled as best they could, sometimes by counter-fraud or even force of arms. Frauds therefore generally were considered personal or civil wrongs. However, it is interesting to note that forgery, which is actually a particular type of fraud, was considered a crime against the king and the state as this offence might affect anyone in the realm, and consequently, it carried the death penalty.

With the passage of time the law has come to make greater provision for frauds both as to criminal and civil recourse. Provisions for the crime now appear on the statute books with a more adequate and equitable basis of punishment.

DEFINITION

The word fraud is derived from the Latin *fraus*, meaning deceit. It is a common law term for which there is no comprehensive definition. The *New Century Dictionary* (1953) provides the most enlightening description as "deceit or trickery deliberately practised in order to gain some advantage or end unfairly, dishonestly, or to the prejudice of another's right or interest (as, to obtain a prize or carry an election by fraud; to allege fraud in a bankruptcy case or in the administration of an estate . . . frauds in business operations; . . . a deception, artifice, or trick; . . . anything contrived or intended to deceive)". *Black's Law Dictionary* states that fraud in general consists of some deceitful practice or wilful device resorted to with intent to deprive another of his right, or in some manner to do him an injury. Buckley, J. in *Re: London and Globe Finance Corporation 1903*, 1. ch 723 (as approved by Darling, J. Court of Criminal Appeal—*Rex v Bennett 23, C.C.C. 609*) states: "To deceive is, I apprehend, to induce a man to believe that thing is true which is false, and which the person practising the deceit knows to be false. To defraud is to deprive by deceit; it is by deceit to induce a man to act to his injury."

The essence of the matter is deceit—some statement or suppression of fact in word or deed with intent to deceive. Fraud is a general term applicable to many crimes and to matters which are not criminal at all, ranging from good natured boasting by the individual to gain personal esteem or others' respect, through the field of practical joking and mischief, the literary, artistic, anthropological, and archeological forgeries, the masquerade in order to travel incognito, to cover up past deficiencies or to attain denied aspirations,

through the "con" man, the high pressure real estate promoter, the "long distance telephone stock broker", the gold mine swindler, to the outright embezzler. All figure in the intriguing story of the ingenuity and ingenuousness of mankind.

The lower scale, so called harmless frauds, are not actionable unless unforeseen injury accrues. In the higher scale some frauds are criminal and others civil, but a conspiracy to defraud is always criminal. Our interest as policemen lies in the field of fraud as a crime, however, as a basis of comparison and appreciation it is well to consider something of the basis of "civil" frauds—particularly as the delineation is sometimes as deceptive as the definition of fraud itself.

CIVIL FRAUD

The civil law requires that certain special elements be proved before the defrauded person can recover damages and in which very stringent remedies can be imposed. In the circumstances of an alleged fraudulent sale, which is a common example of civil fraud, the buyer must show:

- a. that there was a false representation or statement in regard to the commodity or property;
- b. that the vendor knew it was false or lacked sufficient basis for making the statement;
- c. that in making the statement the defendant vendor intended to induce the plaintiff purchaser to act or refrain from acting, in reliance on the misrepresentation;
- d. that there was a reasonable reliance by the purchaser on the statement;
- e. that damages resulted to the purchaser as a result of the reliance.

So to sustain fraud there must be a material misrepresentation which induced the contract, intentional or made with reckless disregard of the truth, as a result of which loss was suffered.

Let us briefly consider some of the basic principles of the civil law that form the foundation of the action for fraud. As a rule, the contract is not invalidated when a person makes a bad bargain by his own poor judgment, ignorance of the law, or a mistake in interpretation of the conditions of an agreement. However, on the other hand a contract is not enforceable where the mistake has been brought about by either a mutual mistake between the parties as to the essential facts of the contract or by fraud or negligence of the other party. In general the rule *caveat emptor* (let the buyer beware) applies to contracts, which implies that the seller

is not obliged to reveal facts to the buyer which if disclosed would be to the seller's disadvantage.

It is appreciated that this rule of law provides leeway for abuse particularly in the fields of commodity advertising, the financing prospectus, and securities promotion, which prompted the noted criminologist Edwin H. Sutherland to comment: "These cases of misrepresentation and fraud have not been subject to prosecution in most cases, for the courts have operated on the principle *caveat emptor*, which has meant that the purchaser must protect himself against ordinary dishonesty and could appeal to the courts for protection only against extraordinary dishonesty. President Roosevelt in 1933 insisted that the principle be reversed and *caveat venditor* be substituted, especially with regard to securities."¹

It should be observed here that this principle *caveat venditor* forms some considerable basis of our provincial statutes and commissions pertaining to securities and also to the federal Pure Food and Drug Act. All such legislation and organizations are designed idealistically at least to control what was a fertile field for the unscrupulous vendor and to protect the innocent purchaser or consumer.

There is an exception to the rule of *caveat emptor*. When a party, lacking knowledge of the subject matter of the contract, enters into an agreement under a mistake as to what the other party's intentions are and the other party is aware of such mistake, the contract is void. However, if a party is simply mistaken as to the intention and the other party has done nothing to convey such false impression, the contract will not be affected. A contract which enables one party to profit knowingly from another's clerical mistake, which is embodied in the contract, will not be enforceable.

MISREPRESENTATION COMPARED WITH FRAUD

In the matter of legal remedies one must consider the difference between innocent misrepresentation and false representation or fraud. Innocent misrepresentation is a misstatement of material facts either not known to be untrue or made without intention to deceive. The misrepresentation must relate to material facts—facts which have induced or brought about the contract—and not just passing statements which would not ordinarily influence decision such as extravagant "sales talk" or "salesman's puffing" of which the

¹ EDWIN H. SUTHERLAND, *PRINCIPLES OF CRIMINOLOGY*, New York, J. B. Lippincott Co., 1935.

public is aware, comes to expect, and consequently discounts. The essential difference between innocent misrepresentation and fraud therefore is the intention with which the false statement is made. Consequently, immaterial misrepresentation is not sufficient grounds on which to repudiate the contract; innocent material misrepresentation when proved is grounds for repudiation of contract; and finally fraud is a basis of repudiation of contract and also a claim for damages. Both actions for repudiation and for claim for damages must be undertaken without undue delay on discovery of the misrepresentation. Further, in event of a resale of fraudulently obtained property a person cannot recover his property against some innocent purchaser who has bought it without notice of fraud.

STATUTE OF FRAUDS

A consideration of the law relating to fraud would be incomplete without mention of the Statute of Frauds. This was an important English law passed in 1673 (29 Charles II ch.3) which with modifications has exerted a notable influence on the laws of the English speaking world. Its intention was to require written evidence for verbal in many classes of transactions with the object of prevention of fraud and perjury. Its effect is to make writing essential to the validity of many contracts or transactions. Consequently, conveyances, wills, and leases were required to be in writing and signed, and no action could be brought on certain agreements unless the plaintiff could prove the agreement by writing duly signed.

Therefore, in particular the Statute of Frauds required the following to be in writing: (1) Administration of estates; (2) Promise in answer to a debt, default, or miscarriage of another person; (3) Agreement in consideration of marriage; (4) Contracts on sale of lands, tenements, or interest thereof; (5) Any agreement that is not to be performed within one year; and (6) Sales of goods over a certain value (£10), otherwise the buyer to receive some of the goods sold or something be given in earnest to bind the bargain or in part payment.

CRIMINAL FRAUD AND FALSE PRETENCES

At the outset in considering the criminal aspect of fraudulent acts we must differentiate between the words "fraud" and "false pretences". "Fraud" is a general term and lends itself to many varied and independent offences in which the individual or the public injured have been misled deliberately

and with intent that they should be so deceived, e.g., fraud in the celebration of feigned marriage; fraud in obtaining consent of indecent assault of a female; frauds upon the government; false entries in books to defraud creditors; frauds by company directors; fraud by a public officer.

"False pretences" is used in a statutory enactment of a penal nature and therefore has to do with a certain type of crime and no other. False pretences is properly applicable to obtaining something tangible or capable of being stolen. Obviously false pretences can be defined more exactly than fraud. It is also noted that false pretences has a relationship to the crime of theft.

As a further differentiation it might be said that "fraud" is a statement which the person has no intention of fulfilling. On the other hand "false pretences" is a representation of existing fact, past or present, which is untrue.

It should be stressed that the purpose of criminal proceedings is to punish a wrongdoer for a crime against the state not just against the individual victim; while the object of civil action is to obtain compensation for the individual who has been wronged. Hence criminal proceedings for fraudulent acts are not for the purpose of securing restitution nor can the individual victim properly condone or pardon such an offence.

FALSE PRETENCES

There are four ingredients to an offence of false pretences, without which a charge cannot succeed: Representation, Property, Intent, and Reliance. These should be considered with related and basic legal principles.

Representation. A representation must have been made by the accused to the complainant, which representation (verbal, by acts, or otherwise—such as by circumstances, created by the accused, his conduct and natural and reasonable inference conveyed) was untrue and known to be untrue by the accused when he made the representation. This representation must refer to an untrue existing fact, i.e. past or present and not something to transpire in the future.

A check provides a general example. The presentation of a currently dated check implies that the person has and presumably knows he has an existing account in the bank in question and funds to meet the demand, unless inadvertently and without fraudulent intention overdrawn. On the other hand a post dated check, unless dated to mislead or presented with other implications of an

existing account, does not stand the test of "a representation of facts, past or present". It is merely a promise to pay in the future, thus assuming the nature of a promissory note as opposed to a readily negotiable instrument, and a matter for civil action rather than criminal prosecution for false pretences. False pretences cannot normally succeed on a representation of something to be done in the future even though the promise was made fraudulently.

It should be noted here that persuading a person to make a promissory note by means of a false pretence is not an offence under Section 304 (1) (a) Criminal Code of Canada as "credit" is not something of which the offence of theft may be committed, such as is the case of obtaining goods by means of a worthless check. Obtaining credit by false pretences is provided for in Section 304 (1) (b), and it must be shown that trust not money was so obtained.

Property. It is essential that something "in respect of which the offence of theft may be committed" (capable of being stolen) be obtained by the accused from the complainant or delivered to another person either directly from the misrepresentation or indirectly as a result. The relationship with theft is again evident, but a clear distinction should be drawn between "false pretences" and "theft by trick" even though both are based on fraudulent circumstances. The test is whether the complainant parted with both physical possession and title or ownership (false pretences) or possession only (theft).

There are three separate offences under Section 304 (1)(a) C.C.: (1) Obtaining property directly by false pretences; (2) Obtaining property indirectly through the medium of a contract obtained by a false pretence; and (3) Obtaining by false pretences the delivery of property to another person.

Intent. There must be intention to defraud, which can be drawn by inference from the representation made and the property received as established in evidence. Buckley, J. in *Re: London and Globe and Finance Corporation* states "... to deceive is by falsehood to induce a state of mind; to defraud is by deceit to induce a course of action."

Reliance. The complainant must have relied upon the untrue representation as genuine, and the misrepresentation must have been material in that it provided the inducement upon which the property passed. A charge of false pretences will

not stand if the victim was not misled by or as a result of faith in the material misrepresentation of the accused and acted finally on his own judgment. However, a charge of attempted false pretence may succeed, as attempt is complete when the false pretence has been made with intention to defraud. Reliance is the link between the false representation and the ultimate passing of property which is essential to the charge of obtaining by false pretences. Further, the false pretence continues to the time of obtaining as long as there is a direct connection between the initial pretence and the ultimate obtaining.

EXTENT OF FRAUD

Money is the life-blood of business, and at the same time is said to be the root of all evil. It is natural that frauds largely devolve around business, in fact or fancy. In fancy the bigger swindles present the imposing business front all the better to beguile while behind the facade exists an empty shell of business organization. It is not the purpose of this essay to explore the more fanciful manifestations of business fraud but to confine ourselves to the factual or fraud in genuine business operations.

There are two broad classes of fraud to be found in business: those committed usually by employees in order to conceal actual theft, and those perpetrated usually by management. The latter frauds do not normally involve theft, at least not directly, and take the form of manipulations to present a false financial condition by overstatement or understatement depending on the purpose: to the detriment of investors, for creation of secret reserves, the defrauding of taxation, credit frauds as disclosed by bankruptcies, stock frauds as exposed by security enquiries. What has been called "White Collar Crime" falls into this class. This type of "crime" involves corruption, manipulation of contracts, graft, patronage, and the like as manifested in the "mink coat and deep freeze" era in the U.S.A. Combines, price-fixing, restraint of trade, "loan sharks" operations, and fraudulent advertising could also be included in this category of "crime". The type of crime is borderline and usually involves those with position to take advantage and the power to evade.

In this paper we shall confine our interest to fraud committed by employees in order to conceal theft, called embezzlement, and taking the form of defalcation and forgery. Losses from embezzlement in the U.S.A. and Canada attain the stagger-

Table 1
Number of Convictions in Canada

	1951	1952	1953	1954
Embezzlement.....	131	141	140	181
False Pretences.....	3747	4175	4570	4903
Fraud & Corruption....	147	58	139	184
Forgery & Uttering....	1950	2224	2128	2905
Perjury.....	49	45	35	53
Blackmail & Extortion.	25	11	30	25

ing figure of over \$500,000,000 for a year, and yet embezzlement losses are less than half that involved in credit and stock frauds. Embezzlement however is of more direct police interest. It attracts greater attention because of its spectacular nature and the human factor—in that it concerns an individual in whom trust has reposed—and this crime is more readily exposed, traced, apprehended, and prosecuted.

The table 1 of statistics as to the incidence and trend of embezzlement and other crime involving fraud elements provides figures of some significance.

Available statistics reflect Ontario as having approximately $3\frac{1}{2}$ times the recorded defalcations of Quebec, $23\frac{1}{2}$ more than B.C. and Alberta, 31 times Saskatchewan, and 47 times that of Manitoba and Nova Scotia.

Needless to say fraud is of such a nature that the full extent is never known. Considerable fraud goes undetected, and not all that is discovered is made public. Other vital considerations, apart from the colossal monetary loss, are the threat to the health and existence of business organization involved in the constant nefarious drain of the monetary life-blood and the loss of human resources represented in both culprits and victims.

CAUSES OF EMBEZZLEMENT

Considerable research has been done on the make-up of the embezzler and much has been written on the subject. By and large there is nothing about the portrait of the average embezzler to set him or her apart from the average man or woman. In a great many cases, it is sad to say but for a moment of weakness or the stress of financial worry, the embezzler might have continued as a normal, useful citizen.

Generally speaking fraud is a bilateral crime, there is both the subjective and objective forces at play. Both the culprit and the victim contribute

their part to the fraud, the defrauder in his cunning preys upon the cupidity of the defrauded in their mutual human desire for easy gain. There are two elements also at work in the crime of embezzlement, one being "management's sin" and the other the embezzler's offence. Management is responsible for placing temptation in the way of his employee, providing the opportunity to defraud through inadequate accounting procedures and lack of proper internal control systems. This element joined with the sudden overwhelming need or desire for more money provides the combination for embezzlement.

As for the embezzler, statistics establish the following general factors as the main causes of embezzlement in the order of relative importance:

- (1) Gambling
- (2) Extravagant living standards
- (3) Unusual family expenses
- (4) Undesirable associates
- (5) Inadequate income
- (6) Resentment or revenge.

METHODS OF EMBEZZLING

Embezzling takes many devious forms depending on the ingenuity of the individual and the systems with which he must cope in accomplishing his misappropriation. The following have been noted as the more common methods of embezzling money:

1. Defalcation by receiving cashiers in charge of cash books (a) by making correct entries and deposits but pocketing the proceeds of a cash sale in outright theft; (b) withholding receipts and failing to enter them in the cash book or deposit slip; and (c) taking money to cover up a shortage of a prior date and deferring entries in cash book accordingly, thus working on the "lag" (called "lapping").
2. Defalcation by a receiving—paying cashier in charge of cash book and with access to other records. Such a cashier—bookkeeper has a limitless opportunity for peculation through manipulations of records to cover his misappropriation both in posting actual accounts or creating fictitious ones, such as misappropriating cash and charging the amount to fictitious customers' accounts.
3. Using cheques in payment of accounts of fictitious suppliers and cashing them through a dummy (requiring collusion), or by forged or faked endorsements. This type of fraud is com-

mon where the cashier has check signing authority or the proprietor in signing fails to scrutinize the invoice.

4. Raising amounts of checks and supporting invoices and vouchers after they have been officially approved.

5. Issuing and cashing checks for returned purchases that have not actually been returned.

6. Forging checks and destroying them when returned by the bank and then concealing the transactions by juggling the totals ("forcing footings") in the cash books or by raising the amounts of legitimate checks.

7. Double payment by issuing duplicate checks for the same creditor's invoice and retaining the second check.

8. Appropriating checks made payable to "cash" or "bank" supposedly for creditors' accounts, payment of notes, or other expenses.

9. "Kiting" checks by issuing a false check on a distant bank and using the time lag and another check to make good the first, and repeating the process.

10. Pocketing part of customers' payments and offsetting them on the books by improper credits for returned goods, allowances, and discounts.

11. Invoicing goods below listed prices and taking a "kickback" from the purchaser.

12. Pocketing collections made on presumably uncollectible accounts, aged accounts receivable, or accounts already written off as bad debts.

13. Charging customers more than the duplicate sales slips show and appropriating the difference.

14. "Dipping" the cash register and tampering with the tape to cover the misappropriation, such as by ringing up \$5.00 on a \$10.00 cash sale and pocketing the \$5.00 difference.

15. Increasing the amounts of suppliers' invoices and pocketing the excess or splitting with the creditors.

16. Failing to enter records of returned purchases, allowances and discounts and retaining equivalent amounts of cash.

17. Padding payrolls in the matter of rates of pay, working time, production, numbers of employees, fictitious or dummy employees and the like.

18. Pocketing unclaimed wages, dividends, and refundables.

THE ACCOUNTANT AND THE POLICEMAN

The detection of business frauds and defalcations was once considered to be almost the sole function of the public accountant. In the accounting profession there has been a tendency to relegate this function to the background because of the widening scope of the accountants' activities, particularly in the field of constructive needs of business as business adviser, financial expert, and the like. As a result too little attention has been devoted to commercial irregularities, business frauds, and financial defalcations. True the function has been passed to some degree to the external and internal auditor, but this does not fully compensate for observance in the normal accounting procedures.

On the other hand there has been a tendency for the police function to enter in only in the more spectacular and obvious aspects of fraud-law enforcement. As a result, it seems an ever widening gulf exists between the business audit function and the law enforcement function, where many offences of public interest and liability go undetected or, if detected, are covered up only to go on spreading their vicious culture.

The closing of this gulf is in the public interest as well as to the mutual benefit of the accounting and law enforcement professions. There should be a drawing closer together in the common interest and reciprocal exchange and utilization of techniques and information—a developing of a common meeting ground and a greater spirit of co-operation and understanding. In the field of fraud the accountant is an investigator, and perforce the investigator must needs become an accountant. Their interest and functions are inextricably interlocked in this vital phase of crime.

COUNTERACTING FRAUD

This in itself is a broad subject which does not permit of full treatment in this paper. However, certain of the more salient measures and devices for the prevention and detection of fraud should be considered in rounding out our theme:

(1) *Internal Control*. This is a scientific distribution of duties and responsibilities within a business organization (division of labour) in order to establish a system of checks and balances so designed that the activity of one officer or employee will automatically, continuously and with minimum of duplication check the work of others and thus safeguard the assets and con-

firm the accounting records. It is supplemented by the internal and external audit.

(2) *Personnel Management.* Close attention should be given to screening of personnel to weed out unfavourable applicants and thereafter by personnel problem supervision and satisfactory working conditions forestall the human situations leading to fraud.

(3) *Business Machines.* Numerous devices are available as fraud deterrents including improved cash registers; protectographs; check writers; business forms systems; special cameras to simultaneously photograph the check casher, his check, and identification; safety paper for checks and negotiable instruments; perforating typewriters.

(4) *Bonding, Guaranty, and Surety Companies.* Insurance provides both financial protection, control guidance, and even detection service.

(5) *Commercial Sources of Information.* There are a number of reliable and efficient organizations providing a service to business and the public and a valuable source of information to the investigator. Some of the more noteworthy are:

- Better Business Bureau
- Dun and Bradstreet
- Canadian Credit Mens' Trust
- Credit Bureau of Canada (and America)
- Retail Credit Association
- Mortgage Companies
- Guaranty Trust Companies
- Insurance Companies
- Banks
- Canadian Fire Underwriters
- Boards of Trade
- Chambers of Commerce
- Canadian Automobile Theft Recovery Bureau
- Retail Merchants' Association
- Canadian Manufacturers' Association
- Finance Companies.

(6) *Public Education.* This medium is of the greatest value in controlling fraud. Public awareness through every medium of publicity helps to forewarn, forearm, and forestall. The repetitious nature of swindles with similar modus operandi—or just the same old pill with a sugar coating—is remarkable. Constant education as demonstrated in the RCMP *Crime in Your Community* publications and a well advised public are sometimes the only means to combat the “artful dodger”.

(7) *Governmental Provisions.* Much is being done

and remains to be done in the field of governmental control of fraud by aggressive legislation, securities controls, commissions, combines investigation, labour legislation, and improved social and working conditions.

AUDIT-*INVESTIGATION*

Having stressed the relationship that exists between the auditor and the policeman in the common objective of fraud detection let us consider some audit techniques which can be of value in police investigation:

1. *Accounting Records.* For our purposes these include: (a) *Books of account*, comprising journal, ledgers, or a corresponding ledger card system—cash book, check records, minute book, stock records, inventory records, financial statements, and the like. In this category we should not overlook “the little black book” as it is a human foible for individuals, particularly bookkeepers, to keep some record of their misappropriations; (b) *Commercial instruments*, including all documents pertaining to a transaction from beginning to end such as purchase orders, inspection sheets, packing slips, weight slips, way bills, bills of lading, manifests, invoices, statements of account, debit and credit memos, deposit slips, drafts or checks, bank statements, and receipts; (c) *Files* containing the correspondence in negotiating the transactions; and (d) *Bank records* and safety deposit box contents.

(2) *Searches and Seizures.* In searches and seizures involving records the question invariably arises in a policeman's mind what to take and how much. Taking records may unnecessarily disrupt a business, but by the same token this concern encourages co-operation. Much depends on the nature of the fraud, the identity of the suspect, existing conditions, and overhanging circumstances. If the scene of the crime is a business and the suspect an employee and the offence embezzlement, then management will willingly place all records and facilities at your disposal including the accountant. On the other hand if a well established business itself is suspect, as in a tax fraud, although too much co-operation cannot be expected from management, it is possible to conduct the examination of records on the scene with relative security of records and often with the benefit of explanations from the accountant as the investigation proceeds. In a case of a more flagrant crime involving a dubious business organization such as

smuggling, securities fraud, a swindle, or some gross criminal racket the records should be seized outright and secured. As to quantity and when in doubt as to selection take the lot, better to have too much than too little. Quantity not only increases the probability of discovering deliberate manipulations but also unconscious oversights on the part of the culprit. The principles of security, continuity of possession, and marking for identification without defacing or adding prejudicial notations are of particular importance in audit investigations.

3. *Organization of Records.* Following even the best organized search and seizure the accounting records are usually in a state of confusion. They should be re-arranged in orderly fashion at the outset—bringing order out of chaos—in preparation for a systematic approach to the audit-examination.

4. *The Audit Program.* A plan of attack should be drawn up outlining the progressive steps to be taken in attaining intermediate and final objectives and check-back verifications. This is set up in logical form and followed closely. The audit program is an essential part of the examination, acting as a guide in the welter of material and confusion which characterizes the beginning of an audit-investigation. It is of little avail in the long run to be haphazard in the advance, as not only can you get utterly lost in the maze but salient objectives can be by-passed and recapitulation is impossible.

5. *Examination of Records.* This phase in the light of the audit program takes two broad forms: (a) The bringing together or “marrying up” of related documents from both the files and commercial instruments; and (b) Examination of records proper which entails following up the questioned transactions, from previous information or leads obtained from “marrying up” pertinent documents, into the postings in the books of account and tracing the ramifications through the accounting records to ultimate disposition and noting discrepancies. The process can be reversed, i.e. from records to documents. The sins of omission as well as commission, important in all criminal investigations, are of particular moment in the audit-investigation as very often an effort to cover up the offence—by manipulation, alteration, adjustment, and human frailty of overlooking minute details in “framing” a situation—usually results in more damning evidence than laid

down in committing the offence itself. This is one field of investigation where the old maxim of “be sure your sins will find you out” is most appropriate. Even when the audit is non-productive in a material sense the very process, inevitable queries and disturbing effects prove of great psychological value in later interrogation of the suspect.

6. *Working Papers.* As the examination of records progresses according to the audit program, notes, listings, breakdowns, and running records should be kept in organized fashion of the material studied for later reference in compiling reports and referring back to the original documents and accounting entries. A system of cross-reference numbering is followed throughout. These records are commonly called working papers and again are an essential to an orderly attack on the mass of material involved.

7. *Schedules of Analysis.* An analysis of special features of the investigation can be better presented in schedule fashion rather than by the composition method. This lends itself to columnar treatment and aids both the investigator and the reader in wading through the intricacies of an analytical study or comparison without losing himself.

8. *Charts.* A compilation of detailed information or explanation of a complex transaction or inter-related transactions can best be presented in charts, providing a clear, organized, and condensed presentation of involved details. Chart presentation takes two main forms: (a) Verbal, either in columnar or flow chart fashion, as commonly used in complicated conspiracy cases; and (b) Graphical, by use of line, bar, or other forms of graphs which not only provide a pictorial presentation of information but also a means of analyzing the information.

9. *Photographic Aids.* Photographing or photostating pertinent documents and manipulation or alteration of records provides a permanent record and also simpler and clearer means of presentation than trying to describe the details in words.

10. *The Audit-Investigation Report.* The covering report should take the form of an overall coordinating brief or summary, referring for details to accompanying schedules of analysis, charts, and photostats of evidential documents and records and merely pointing-up significant conclusions. Where a great mass of material is involved it should be organized, indexed, and

bound in book style for ready reference and easy study.

DETECTION OF FRAUD

The auditor's methods of examination can be of considerable assistance to the police investigator. The following outline provides some common approaches to the detection of fraud in accounting records by audit-investigation which may be useful as a guide to the policeman:

Irregularities re cancelled checks.

1. Examine endorsements and compare with name of payee.
2. Investigate checks made out to shareholders and employees or endorsed by an officer or shareholder.
3. Watch for variations in endorsements—second or even third endorsements.
4. Watch for initials on face of check—this might indicate that a person other than the payee cashed the check and the second endorsement was waived.
5. Examine face and reverse side of checks for erasures and alterations.
6. It is not uncommon for the teller to note on the back of a check the denomination of the bills handed out. If a number of one hundred dollar bills (\$100.) have been listed the payee's records should be examined to see if the income has been recorded.
7. Absence of clearing stamp indicates that check was negotiated at the branch on which the check was drawn.
8. Note the place where check was negotiated.
9. Where it is normal for checks to be typed or written by a check writer, handwritten checks should be investigated.
10. Investigate checks made out either to cash or a bank, particularly large payments.
11. When checks are held for a considerable time before being cashed or deposited, investigate if the income has been reported.
12. Investigate any variation from the normal routine.
13. Keep in mind, when examining checks, that your examination may lead to the discovery of income suppression of the payee as well as the payer.
14. Checks made out to cash for wages, etc., should be test-checked to the payroll records.

15. Check for duplicate checks made out to same account payable.

Deposits

1. Examine the duplicate deposit slips.
2. Cross check check listings to the cash book, including name of payee, if possible.
3. Cross check cash deposits to the cash book.
4. Determine whether cash deposited is in line with size and type of business.
5. Investigate any checks or cash deposits not posted to the cash book.
6. Scrutinize bank statements. Investigate any erasures or alterations.
7. Test check additions.
8. Examine any large deposits.
9. Test check deposit slips to the bank statement or pass book.

Drafts

1. Examine draft register.
2. Determine method of recording receipts.
3. Test check draft register to accounts receivable.

Signing Authorities

1. Peruse copy of company's contract with bank.
2. Get copy of bank authorizations re signing authorizations as shown by the Minute Book.

Loans

1. Investigate any loans to a company made by a shareholder.
2. Investigate subscriptions to stock of company by a shareholder.
3. Investigate the amounts credited by company to a shareholder or proprietor.
4. Check authenticity of all loans.
5. Enquire into collateral put up for loans made by banks to company.

Sales

1. Check bills of lading to Sales and/or Accounts Receivable to see that shipments are accounted for.
2. Check delivery slips to Sales and/or Accounts Receivable to see that deliveries are accounted for.
3. Is Gross Profit percentage in line for the type of business?
4. If sales are to non-residents, test check with Customs Export Entry (B13), or Trade and Commerce Export Permit.

5. Test check sales slips, tapes, invoices, etc., to receipts.

6. If there is a numerical sequence in sales invoices, test check sequence.

7. If suspicious, test check additions—sales may be understated.

8. Check authenticity of credit notes, if necessary verifying with debtor.

9. Are lines of merchandise handled in short supply and therefore commanding a premium?

10. Review sales account in the last month of the fiscal year.

11. Test check factory work orders to sales.

12. Test check credit notes entered in last month of year. Check to third party records if necessary.

Accounts Receivable

1. Check authenticity of all write offs.

2. Check authenticity of all accounts and balances by means of a mailed statement.

Sundry Revenue

Check to see that receipts other than from the main source are accounted for:

1. Special discounts and rebates

2. Volume bonuses (car dealers, soft drinks, tire dealers, etc.)

3. Freight rebates

4. Customs Drawbacks

5. Sales tax refunds

6. Scrap sales

7. Sales of by-products

8. Proceeds from fire or damage claims.

Purchases

1. Check authenticity of purchase invoices, including major purchases of capital assets, if necessary verifying with creditor. Verify with covering check.

2. Watch for duplicate copy of purchase invoices put through later and payment applied against personal account of shareholder.

3. If suspicious, test check additions—purchases may be over-stated.

4. Examine purchases for the last month of the fiscal year.

Accounts Payable

1. Check for fictitious liabilities, creditors, to which checks may be drawn.

Payroll

1. Checks made out to cash for wages, etc., should be checked to subsidiary payroll record to see that all monies were paid out to employees.

Inventory

1. Inventory understatement is not necessarily fraud but is indicative.

2. Where a cashier pockets proceeds of cash sales and there are no sales slips used, the misappropriation can usually only be disclosed by a careful inventory check or stock-taking because an inventory adjustment would have to be made for the goods sold and not accounted for.

General Journal Entries

1. Scrutinize all general entries.

General

1. Peruse minute book, looking for unusual authority to officers.

2. Examine insurance policies.

3. Pay particular heed to businesses where chief shareholder(s) has proprietorship or partnership as well, one operating complementary to the other.

4. One cannot divorce fraud on a large scale from income tax evasion.

CONCLUDING OBSERVATIONS

Canada is progressing economically from the primary to the secondary stage of production. From a country of basic or extractive operations we are becoming a major industrial and commercial nation. This century is for Canada what the last century was for the U.S.A. From the law-enforcement point of view such a change naturally increases offences of a commercial nature, with crime in business and business in crime. These conditions are accentuated and aggravated by the rapid transition and unprecedented expansion which have characterized our economic evolution, stimulated by the impetus of the Second World War and the momentum of post-war development.

We can anticipate a greater demand for investigations of a complex nature concerning business organization and financial matters. It is reiterated that not only can we expect a growing incidence of crime involving ordinary businesses but also crime itself being organized and functioning on syndicate or big business lines. Law enforcement

is also becoming more closely integrated with governmental institutions responsible for the regulation of commercial activities. Finally, we may become increasingly concerned with borderline crime or irregularities in both government and business—so called white collar crime—presenting something of a new field of investigation.

All these facets of an expanding law-enforcement function reflect significant fraud ramifications which render themselves to special treatment and the techniques of audit-investigation. In keeping pace with the economic growth of our country the Canadian policeman should be prepared and equipped to cope with the trend of the times and to better perform his function in the field of commercial investigation. For the policeman the accounting book is taking the place of the brand book.

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