

FRAUD FINDERS

Forensic accountants use their number-crunching skills to ferret out fraud and provide litigation support. In today's scandal-prone business climate, it's the fastest-growing job in the accounting field.

By Jake Poinier

Numbers don't lie. "But liars do," says forensic accountant George M. Lewellen, CPA, CVA, in San Francisco. And sometimes the liars don't try very hard to cover their tracks. "During one investigation, we found in the audit working papers a statement written in the margin by the internal audit manager: 'Conceal from bankers,'" says Nicholas L. Feakins, CPA, a partner at San Mateo, Calif.-based forensic accounting firm Feakins & Feakins. "It sounds amazing, but the [third-party] auditors had put B-level staff on the project who simply didn't read the documents and missed it."

Then again, most guns aren't still smoking by the time the forensic accountants dive into the books to catch what the auditors didn't. Feakins cites the example of MiniScribe, one of the world's largest disk-drive makers, which in the late 1980s was surreptitiously shipping bricks instead of disk drives to the Far East and receiving credit from the bank for the amount of the shipments. "After all," he says, "it's going to be 90 days until they ship the brick back to you." MiniScribe's public accounting firm, Coopers & Lybrand, didn't catch the false-revenue scam during its regular audits-but a forensic accountant did.

Whereas the typical financial audit is a sampling activity that doesn't look at every transaction-and can therefore be exploited by someone who knows how to rig the books-forensic accounting focuses on a specific aspect of the books and examines every digit. And while the average accountant is trying to make everything add up, a forensic accountant is performing a detailed financial analysis to find out why everything doesn't or shouldn't add up. It's a far more time-consuming enterprise and can be significantly more expensive than regular auditing work.

Forensic accounting has become the linchpin in resolving everything from high-profile divorce cases to multibillion-dollar corporate scandals, money laundering and even terrorism. The term forensic accounting-the first part of which implies information prepared for public or legal debate, nothing to do with the blood-and-guts work of forensic medicine-is relatively new, dating back 20 years or so. The types of figure fudging that it's designed to address are as old as the accounting profession itself, but the -volume of cheating has ratcheted up.

"The reason people are suddenly sitting up and taking notice is the magnitude, breadth and publicity surrounding cases such as Sunbeam, Waste Management, Enron and WorldCom, specifically the huge market caps and the significance of their declines," says Kevin Dages, a forensic accountant and principal of Chicago Partners in Illinois. "Suddenly everyone says, 'Oh, this is a new field.' But it really isn't, and it will continue to grow because it's driven by a need to bring a third party in to take a clean look at problems that were overlooked by -normal internal controls."

Counting on Wrong Numbers

Forensic accounting essentially falls into two broad categories: investigative accounting and litigation support. The former includes criminal investigations to uncover various types of fraud, while the latter describes the use of accounting in any matter involving existing or pending litigation, involving such issues as business valuation and damage calculations from breaches of contract. (Those in the field make an additional distinction, further dividing cases between family law-those dealing with divorce and community property-and business.)

"A good forensic accountant is like a three-layer wedding cake," says Larry Crumbley, KPMG Peat Marwick Mitchell Endowed Professor at Louisiana State University and editor of the Journal of Forensic Accounting. "The large bottom layer is a deep background in accounting. The second layer, not quite as big, is a background in investigative auditing. For the top layer, a forensic accountant needs to know the law. Around the wedding cake is icing, which is excellent oral and written communication skills-since they're going to have to write a report to get their point across, and they're going to have to testify in court."

That final component is something that top forensic accountants relish, whereas a traditional CPA might dread the idea of being shredded in cross-examination on the witness stand. "Expert witnesses are not supposed to advocate for their client, they're supposed to advise the court on a narrow range of facts in a legal context," Lewellen says. "But we are advocates of our opinions. Our job is to convince the court that we have analyzed all the pertinent facts and that our

conclusion is a logical extension of the fact pattern that we're presented with. We don't just sit there and dryly spout numbers; we put them in a framework that judges and juries can understand."

Describing the proliferation of accounting scandals that have led to a boom in his field, Feakins implicates a cascade of events: the failure to learn from the savings and loan crisis 25 years ago, the marriage of auditing and consulting functions at the major accounting firms, and the decline in students choosing accounting as a profession. His prognosis is dire indeed: "One advantage that the U.S. has had over other countries in terms of attracting investment is that our securities laws are stronger than any other country in the world," he says. "To the extent that the big accounting firms have undermined the effectiveness of those laws, it undermines our entire economic system."

Crumbley points to a shift in the mid-1980s to "top-down" auditing, when the major CPA firms dropped their audit fees and replaced them with non-audit fees from consulting. "They began to use computers more, and they began to audit the controls rather than the details," he says. The firms didn't look at the numbers or accounts, but they certified them anyway, based on trust. In effect, they quit auditing. "We are going to have to go back to looking at the details," Crumbley says.

Without defending the widespread public accounting misdeeds, Dages cautions against too strident a viewpoint against the non-audit fees. "It's a difficult thing to decide," he says. "If you're not going to allow the accountants to make a living, sooner or later the accountants are going to go away-and then where do you stand? You need to let the market forces work through. There needs to be some kind of balance between what you're paying the accounting industry as a whole to do and what you're expecting them to deliver."

Growth Factors

Litigation support and forensics/fraud are among the top four growth niches in the industry, according to Accounting Today's 2003 Top 100 Firms survey. There are several factors that will continue to push the trend, starting with the fact that there is simply more business litigation than ever before, which Lewellen has witnessed firsthand. "In the 1970s, as a group of professionals, we discovered that litigation is a good revenue source," he says. "Lawyers found that CPAs were good at it; CPAs found that it was fun and profitable."

Second, in the wake of the high-profile accounting scandals, the federal government has stepped in and created an unprecedented opportunity for any accountant with a sleuth's eye. The Public Company Accounting Oversight Board (PCAOB, pronounced "peekaboo"), created by the Sarbanes-Oxley Act of 2002, has been tasked with overseeing the audits of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, fair and independent audit reports.

More specifically, Sarbanes-Oxley requires executives to certify their financial statements. Putting a fine point on the impact of Sarbanes-Oxley and PCAOB, Crumbley notes that the difference is that fraud perpetrators can now be put in jail-and that CFOs won't be able to plead ignorance to the U.S. Department of Justice. "The internal controls and auditors are going to need to get involved in certifying the numbers," Crumbley says. "Therefore, all of these groups are going to need to use forensic techniques and enlist forensic accountants to find the fraud."

Noting that about half of all fraud is found by tips-and much of the rest by accident-Crumbley likens the process to taking a metal detector to the city dump to try to find rare coins. "You get a lot of false hits," he says. Asked if people are any more corrupt or likely to engage in fraudulent activities in the current market climate, Crumbley says, "As the stock market boomed, as corporations tried to keep their stocks going up and up, they had to engage in cooking the books. Over the past five to seven years, the dump got bigger." -