

Forensic Accountants: Specialists in Demand



By Eddie Lee

An employee embezzles millions of ringgit from his company but he doesn't know his firm is on to him. To combat his schemes, the company brings in a forensic accountant, a professional with a combination of financial expertise and investigative prowess, to determine exactly what's going on. Eventually, the forensic accountant uncovers the fraud, gathers evidence, and turns it over to the police. The employee gets convicted and goes to prison.

This is not the plot of the latest Hollywood blockbuster, or the latest corporate accounting scandal for that matter. This is a typical example of a day's work for a forensic accountant.

Forensic accounting has gained renewed attention due to a spate of accounting scandals but it has always been a part of the profession. In fact, forensic accountants were credited with putting Al Capone, a Mafia boss, in prison on tax-evasion charges. Given the amount of money organisations lose to fraud and abuse it's no

wonder forensic accounting is one of the fastest-growing sectors, not just of the accounting field but of the world of work as a whole.

According to PwC Malaysia, the 2011 PwC Global Economic Crime Survey indicates that asset misappropriation is the most common form of fraud in Malaysia where 83 per cent of respondents stated they had suffered from asset misappropriation in the previous two years.

"In my experience, these figures accurately reflect reality. In Malaysia, much of the fraud that we see involves allegations of kickbacks and collusion with suppliers," Alex Tan, Executive Director, PwC Malaysia's Forensic Services Team. Forensic accountants and financial crime investigators bring a unique skill set to the table. "Companies are recognising this. They get to the heart of the issue, providing the Board and management with an independent and expert view," he adds.

Currently, there is a worldwide trend for a move towards converging local accounting standards with the IFRS issued by the IASB. The standards are now used by various countries around the world both by the developed nations and also the emerging. Fraud losses are hard to quantify. The Association of Certified Fraud Examiners estimates that companies lose approximately 5 per cent of their revenues to fraud each year. This is a staggering figure. According to PwC's 2011 Global Economic Crime Survey, 44 per cent of Malaysian respondents reported suffering from some form of economic crime in the previous two years. This has placed Malaysia at the 10th spot out of 78 countries. While this may sound alarming, Malaysia ranked better than countries traditionally seen as 'cleaner' such as the UK, New Zealand, Australia, France and the USA.

Whether it is nabbing gangsters, identifying corporate misdeeds or exposing terrorists, forensic accountants are in demand. In fact, most of the accounting firms are expanding their forensic and fraud services. Private companies are not the only ones asking forensic accountants to hunt for wrongdoings. Government agencies like the police, the Inland Revenue Department and other government agencies have forensic accountants who investigate everything from money laundering and identity-theft-related fraud to arson for profit and tax evasion.

Law firms often use forensic accountants to help divorcees uncover their ex-husbands or ex-wives hidden assets. In recent months, forensic accountants have uncovered instances of companies cooking the books to falsely inflate company profits, minimise losses or divert large amounts of money to company bosses.

In Malaysia, the most popular fraud cases uncovered have been linked to the procurement process. Deloitte Malaysia relates an interesting case. Some years ago, they investigated a fraud in the subsidiary of a multi-national company in the manufacturing sector. The subsidiary had a total of about thirty employees and a small accounting team of three people, one Senior Accounts Executive and two juniors. They found that the Senior Accounts Executive had set up his own company and the company of an accomplice as vendors in the accounting system of the company, raised false invoices to those companies and then completed and authorised telegraphic transfers to the companies. The junior staff



was unaware of the fraud as their Manager took sole responsibility for liaising with the bank and concealed documentation relating to the fraudulent transactions. A total of RM8 million was siphoned out of the company in twelve months.

"So, we see a lot of this sort of thing and factors contributing to them are a lack of Head Office oversight (particularly in the case of MNC's), no segregation of duties in key accounting functions, an overbearing or senior person in a key function who is less inclined to be questioned and fundamental practices like bank reconciliations not being conducted or not conducted often enough," notes David Lehmann, Head of Forensic, Deloitte Malaysia. Just reviewing the vendor listing periodically may well have identified the fraudulent vendors and the fraud much earlier.

Companies like Sime Darby Bhd, CIMB Group Holdings Bhd, Alliance Financial Group Bhd, Petra Perdana, Transmile Group Bhd, Megan Media Bhd, Liqua Health Corp Bhd have resorted to forensic accounting to address issues on suspected fraud or abuse of authority.

"In Malaysia and many South-east Asian countries, many companies are still trying to deal with fraud related issues 'in-house,'" says Lehmann. According to him, there are many reasons for this, including costs and not wanting to 'air their dirty linen'. If the matter is small in terms of financial loss, then if there is some capability to investigate within the organisation, this may be adequate.

However, if a matter is significant due to a large financial loss, the type of fraud, i.e. financial misstatement fraud or the persons involved, i.e. senior management, then engaging a third party with the appropriate skills and capability to investigate the matter thoroughly is very important. "It is even more important in cases where publicly listed companies identify significant fraud related issues because this has implications, in some case very serious

implications for the stakeholders involved, i.e. shareholders, employees, suppliers and regulators. These stakeholders will want to know the true position in respect of the fraud so that they can assess how it will affect them and this can really only be achieved through independence in the investigation process," he stresses.

Forensic specialist, familiar with all the red flags that indicate suspicious financial activity in both bank and non-bank institutions, can help you uncover even the most subtle and sophisticated money laundering schemes. "Well," says Tan, "the word "flag" is a misnomer as it creates an impression of plainly visible warning signs when, in fact, none may exist - fraud after all is a crime of deceit and deception. Fraud risk factors are much more appropriate. There is difficulty in identifying and interpreting fraud risk factors.

- Fraud risk factors are not the same as evidence of fraud
- Fraud risk factors may indicate risks other than fraud
- Fraud risk factors can be ambiguous i.e. susceptible to both sinister and innocent interpretations
- There is no linear relationship between the number of fraud risk factors and the level of fraud risk
- Fraud risk factors are of limited significance in isolation
- Some fraud risk factors (i.e. an individual's state of mind) are very difficult to observe.

Fraudsters know that companies engage forensic accountants to go through the company's books and yet they did it anyway. "I'm

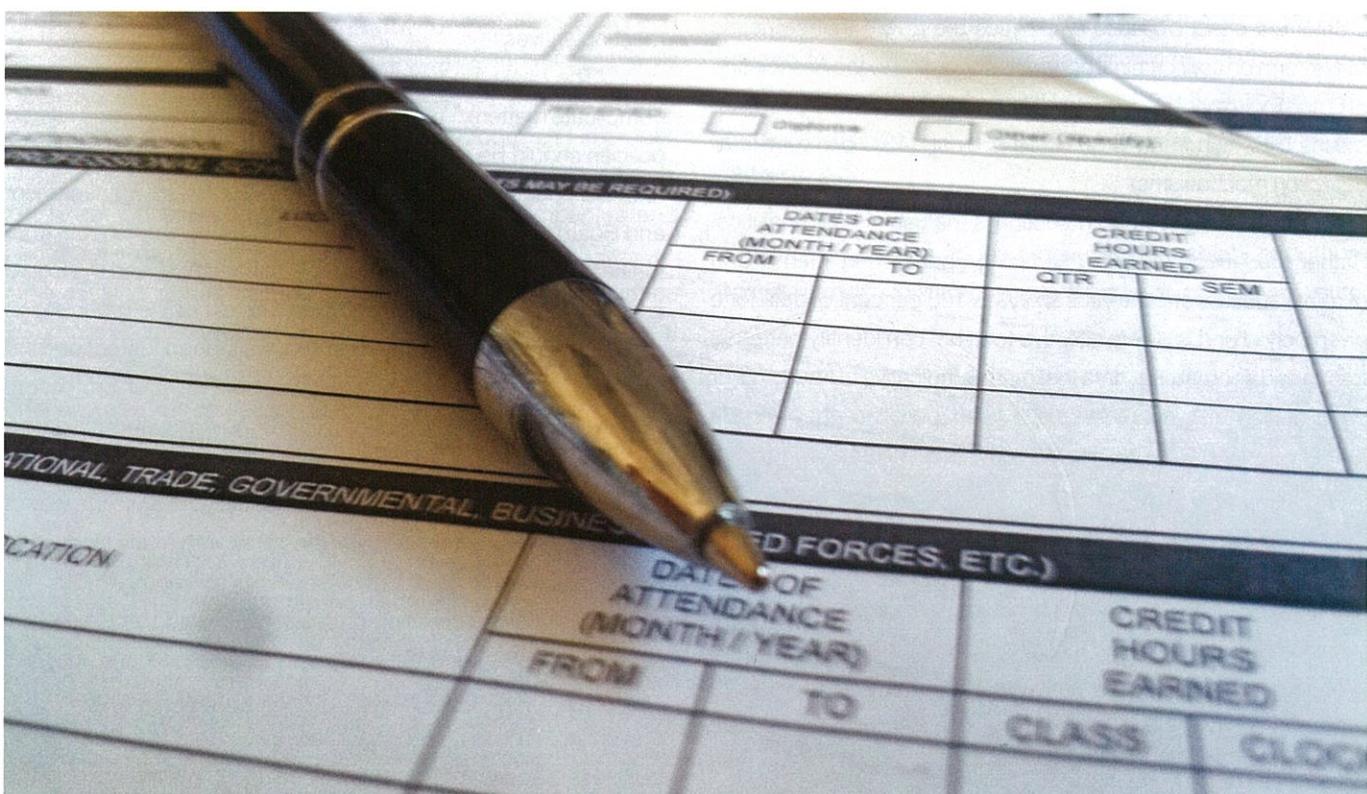
sure that many people do believe that they won't get caught or they rationalise what they are doing by telling themselves that they will only do it once and it won't really matter," says Lehmann.

There are many factors that contribute to why people commit fraud; the oldest motivator being greed and issues like gambling or just getting into debt problems. Many people test the water, so to speak, by trying something that is small and will fly under the radar. If nothing happens, then fraudster becomes more comfortable with their conduct and the feeling that they won't get caught. This is when the prevalence of the conduct increases and often leads to them being detected sometime later.

Fraud can never be prevented 100 per cent of the time but the fundamental approach to minimising fraud and its detrimental effects is to be vigilant. Fraud control is based on the key areas of prevention, detection, incident response and monitoring.

"There is no one size fits all anti-fraud program," says Lehmann who joined Deloitte in 2004 after completing 23 years of service with the Victoria Police, Australia, with a majority of that time dedicated to the investigation of fraud-related incidents. The program adopted by an organisation will depend on many factors such as the size of the organisation in terms of revenue and employees, industry specific factors, complexity of operations and geographical location of operations.

All organisations should have preventative measures in place and included among these is having documented policies and procedures relating to fraud control. There should be a code of conduct or code of ethics that clearly articulates the company's



position in respect of fraud and corruption and other areas of importance such as but not limited to confidentiality of information and whistleblowing.

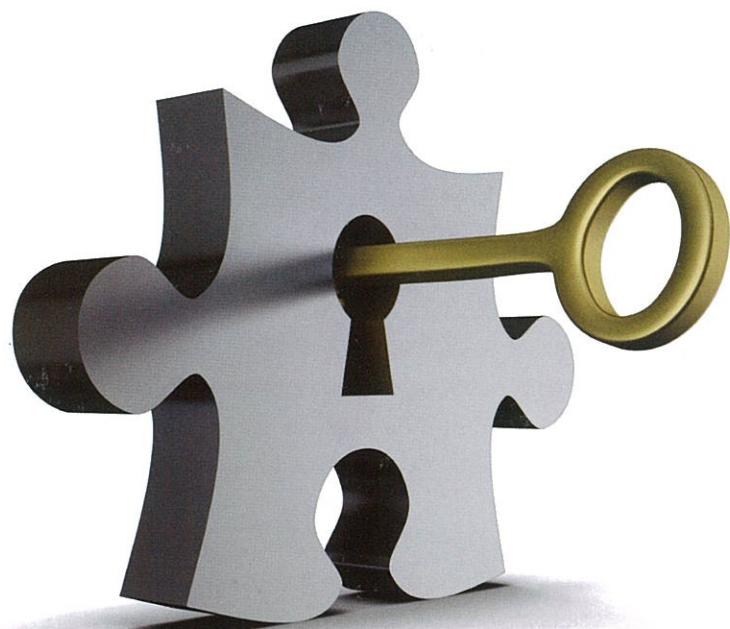
A strong ethical culture is the key to combating fraud and corruption. For large organisations, there should be standalone policies and procedures on areas such as but not limited to fraud and corruption control, whistleblowing and IT. In order to produce the desired deterrent effect of these policies and procedures, there should be on-going fraud, ethics and whistleblowing awareness, including training, to ensure that all staff are fully aware of expectations and the signs or red flags of fraudulent conduct.

Another key preventative measure is to understand the fraud risks of the organisation by periodically conducting a fraud risk assessment. This first of all involves determining all the possible fraud risks to the organisation and then rating these risks for their likelihood of occurrence, the consequences of them occurring and an assessment of the effectiveness of the controls in place to deal with the identified risks. By doing this, the highly rated risks can be identified and dealt with in a detailed fraud control plan. This process should be conducted periodically because business risks, including fraud risks, change over time.

In terms of detection, having an anonymous whistleblowing mechanism is a key to helping organisations not only detect fraud, corruption and other serious misconduct much earlier, but also has a deterrent effect because employees are aware that someone may inform on their criminal conduct. According to the Association of Fraud Examiners Report to the Nations 2012, the most prevalent means by which fraud is detected is by tip (43.3 per cent of all detection mechanisms)

Another key to fraud detection is the use of data analytics. Rather than just adopting a sampling approach in internal and external audits, data analytics analyses 100 per cent of data for a given period and is a very effective tool that can identify patterns, trends and anomalies in data that may be indicative of fraud and/or error. Once these anomalies have been identified, they can be further investigated by looking at source documentation and other enquiries.

Having a clearly defined fraud incident response plan in place with clearly articulated responsibilities is very important because uninformed actions taken at the outset of an investigation may negatively impact the ability to collect all available evidence and the prospects of recovering stolen assets. Various stakeholders, such as Finance, IT, HR, Legal (in-house or external) and forensic practitioners or internal investigation resources should be included in the planning process and agree an investigation strategy, i.e.



determining sources of relevant, available evidence and avenues of enquiry, to achieve the desired outcome.

Monitoring refers to the monitoring at a transactional day-to-day level as well as monitoring the currency and relevancy of your overall fraud control program. As business operations change, so do the fraud risks confronting that organisation. To achieve continuous improvement in fraud control, the measures an organisation has in place should be monitored to make sure they meet objectives.

"The basic fundamental of fraud prevention is not to over complicate matters," Tan emphasises. For example, fraud related policies should be short, sharp and to the point. "Who wants to read a 20 page fraud policy," he questions. "Senior management and Board commitment is vital. The old saying "the fish rots from the head" is true with fraud. If senior management and the Board are not committed, then why should the rest of the organisation care?" It should be complemented with good detection and response strategies that provide a decent level of protection. However, nothing is fool proof and there is no sure way of mitigating fraud risk to zero.

According to Tan, there is, unfortunately, no absolute way of detecting all fraud. It is a complicated area with many facets that are coupled with an organisation's own risk tolerance.

A forensic accounting professional is said to be one part accountant, two parts detective and legal expert and they are involved with a variety of projects, including fraud investigation and prevention. These professionals are also called upon to analyse business transactions and serve as expert witnesses during litigation. In addition, they often work with government

organisations searching for suspicious corporate financial activities and evaluating banking records of suspected terrorists.

If company decides to pursue legal recourse, the forensic accountant is ready to stand as expert witnesses to testify about the specifics of the crime uncovered during forensic accounting investigation. They will also educate the court as to the nature of forensic accounting and fraud examinations. This also applies in cases when companies intend to recover stolen funds from the fraudsters. Law firms agree: evidence alone does not always win a court case. Sometimes, you need an expert witness to remove doubt from the minds of the judge.

But the number of convictions is low in Malaysia. "You look at the statistics when it comes to court cases; they fail to prove the crime. Based on my feedback, the quality of investigation is below par in number of cases. While investigating a corporate fraud one must develop all possible hypotheses and test it before being judgmental," says Prabhat Kumar, a director with Alliance IFA (M) Sdn Bhd, a company that specialises only in investigative and forensic accounting.

"You must be able to communicate in a simple manner without opinion with convincing facts and language. Ornamental and technical language is one of the hurdles, which reduce the effect of findings, as it is neither understood well by the lawyer nor by the judge. A forensic accountant can assist the court by explaining complex financial issues in a simple manner so that it can be understood together with his expert opinion," he adds.

Fraud can sometimes be a difference between a company making a profit or suffering a loss. To ferret out fraud, a forensic accountant must have the skills of both a private investigator and an accountant. This means analytical abilities and research skills are essential to succeed as well as financial experience including knowledge of accounting procedure both proper and improper. Often, the forensic accountant is misunderstood by accountants at large, observes Prahbat. "Unfortunately companies and business entities also have misunderstood this term."

Rising fraud cases have prompted the Securities Commission to issue a stern warning to top managers and directors to stop the destruction of or causing the loss of company documents. "It is completely unacceptable that a company that is under investigation suddenly turns around and claims that documents are lost or stolen," said SC Chairman Tan Sri Zarinah Anwar.

Securities Commission aside, companies are changing the ways in tackling fraud and mismanagement. They prefer to take a stronger line of action rather terminating the employee and bearing the losses. Lehmann agrees, "Companies in South East Asia are beginning to take a harder line against identified fraudulent conduct and this often includes referring the matter to police for further investigation and prosecution as well as taking civil action to

recover financial losses from the fraudster. Approaching fraud like this, as well as publicising the matter and how it was dealt with by the company, sends a very clear message to employees that the company will not tolerate fraudulent behaviour".

Companies that do not wish to go to such lengths and allow perpetrators to resign and leave, expose themselves to risk. "This sends the wrong message i.e. you can steal the company's assets and if caught, you can just resign and go elsewhere," notes Tan. "This pushes the problem onto another company. We have investigated many instances where the perpetrator was allowed to resign and then carried on his (or her) activities elsewhere. A 'zero' tolerance policy to fraud is easy to implement and follow. It removes the risk of having an inconsistent approach and provides a strong deterrent effect."

A lot of companies realise that investigating thoroughly and referring to the police have a greater deterrent effect. "Certainly," agrees Prabhat, "but our police force has a long way to go when dealing with white collar crime. Other law enforcement agencies need to be prepared to face the challenges of the electronic world where 90 per cent of the information is stored in soft form prone to alterations and lose its reliability."

Forensic experts also can decide ultimately when evidence means a win or loss. Information gathering that produces hard, useable evidence to win a case is not always a simple task. Well-meaning people who don't know the laws of information gathering and evidence retrieval often mishandle, or acquire evidence illegally. This taints your case—and lets the guilty go free. One must be well versed in the laws of information gathering, forensic evidence and evidence retrieval. Forensic evidence specialists are trained to remove obstacles, gather information, and collect evidence within the boundaries set by the law. If criminal evidence exists, let the forensic specialist pursue legal and just ways to obtain it.

Forensic accountants are very useful in more ways than one. Whether uncovering frauds or investigating abuse of authority, money laundering, the business world just cannot live without them.

