The Role of the Forensic Accountant

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- Forensic accounting usually encompasses investigations, fact-finding and presentation, calculation of quantum, and expert opinion, even if litigation is only a remote possibility.
- A forensic accountant must possess:
  - A firm grasp of relevant law including a working knowledge of the rules of evidence, disclosure requirements, dispute resolution procedure, relevant statutes and case law;
  - Precision, in terms of analysis and investigation as well as the communication of findings;
  - Independence of mind and a rigorously objective approach.
- To be effective, a forensic accountant must possess the technical knowledge of an accountant and the sleuthing skills of a detective.

The term 'forensic', whilst most commonly associated with medicine or science in the context of criminal proceedings, means 'belonging to the courts of law', whether civil or criminal.

Rightly or wrongly, forensic accounting is the generic description given to work carried out, and advice given, by accountants in the context of disputes and claims. It usually encompasses investigations; fact-finding and presentation; calculation of quantum; and expert opinion, even if litigation is a remote possibility.

So what distinguishes forensic accounting from other applications of accounting skills?

Clearly, the forensic accountant should possess a good grasp of relevant law. For example, he or she should have a working knowledge of the rules of evidence, disclosure requirements, dispute resolution procedure, relevant statutes and case law.

An enquiring mind and clarity of thought are essential in order to identify and address properly the key issues requiring accounting expertise. Adopting the saying 'not being able to see the wood (forest) for the trees', the forensic accountant not only needs to be able to see the 'wood', as a whole, but must be able to identify which particular trees in the wood are relevant and important. He or she rarely has the luxury of hiding behind the concept of materiality. Precision, in terms of his/her analysis and investigations as well as the communication of findings, is crucial.

The forensic accountant must also be open minded and sceptical. In most cases he / she will be instructed by one party or the other and will therefore be presented with that party's perspective of their case. He / she may not be told the whole truth (and in some cases not the truth at all) and therefore he / she must weigh the different sources of evidence available and state very clearly the basis upon which he / she forms an opinion.

Independence of mind and a rigorously objective approach is crucial. The forensic accountant must always bear in mind the prospect that his / her findings and opinions will be tested quite thoroughly during cross examination in a court of law. He / she should not forget that, as an expert witness, he / she has a paramount duty to the court which overrides the duty to the party instructing him / her.

Enough about the theory, what sort of assignment might a forensic accountant be asked to become involved in?

A good example might be the private bank which collapsed, overnight, with the equivalent of HK$10 billion of debts. The bank's offices had been emptied of virtually everything, except that a 'flak jacket' was found in the Chairman's office! The Chairman had left the country, but not in his private jet.

Instructed on behalf of the pension fund of a well known international company, RSM were asked to investigate the loss of the equivalent of HK$900 million which the fund had invested in the company.

The starting point was an understanding of the bank's business – what were its assets, liabilities, sources of income and nature of its expenses? From there, we needed to understand where the money went. Ostensibly, money invested by the bank's customers was lent to third parties involved in property development. Were the losses a result of some bad investment decisions or the downturn in the property market, perhaps?

It quickly became apparent that monies received from customers was transferred within hours, if not minutes, through various bank accounts around the world. Clearly, that did not make sense. It also became apparent that

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beneficiaries of 'loans' and payments were often related parties – also an unexpected finding. Sizeable payments had been made to the Chairman and other directors over the years and most of the loans were non-performing. In later years 'new' money invested by the bank's customers was used to pay out maturing investments and interest payments to customers.

Our efforts were quickly turned to tracing monies, invested by the pension fund, through numerous bank accounts internationally. In simple terms, the objective was to identify whether there were any assets which the fund could argue were acquired with its money in the hope that the loss could be reduced. Another objective was to obtain evidence that the fund was defrauded and to identify assets held by the directors which could be seized or frozen pending litigation to recover monies from the directors.

In the context of our findings, the pension fund trustees were naturally interested to know why the bank's financial statements, which had been presented to them over the years by the auditors and on which they had relied for the purposes of investing more funds in the bank, showed an improving asset base over time and increasingly healthy profits from year to year. More to the point, why had the auditors felt it appropriate to sign unqualified audit opinions each year?

The reason for the 'healthy' picture depicted in the financial statements was quite simple. The bank calculated interest due on the loans made to its customers and added the interest to the outstanding loan principle and any accumulated interest receivable. The fact that customers were not, in reality, repaying loans or paying interest was treated as irrelevant.

Our attention was soon turned to the files of the 'Big 5' auditor in order to establish what the firm had been told and ascertain why they had not insisted on provisions being made against non-performing loans in the financial statements. We were instructed to prepare an expert report addressing the issue of whether or not the audit firm had carried out its audit competently in the circumstances and, if not, what proportion of the loss suffered by the pension fund were they responsible for causing. The litigation against the auditors is continuing.

This particular case contained several issues on which a forensic accountant might typically be asked to advise. A case of this size does not, fortunately perhaps, occur every day but one only has to think, for example, of Barlow Clowes, Polly Peck, BCCI, Maxwell, Barings, Enron and HIH to realise that they are by no means uncommon.

Forensic accounting, whilst at times very demanding, is undoubtedly varied, interesting and rewarding. It is certainly a career path worthy of consideration for those with qualities of a detective in them!

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