

# PDI INSIGHT

## Forensic Accounting A growth option for accountants

Professional Development Institute  
Issue 2 | Summer 2013

Forensic accounting is a dynamic field that has grown over the last 20 years or so, in large part because the courts have decided they need help on some of the technical issues their cases entail, said Al Rosen, CMA, FCMA, principal of Rosen & Associates Limited, litigation and investigative accountants in Toronto.

Moreover, the variety of cases is also increasing. Rosen's firm, for instance, has had to deal with a wide range of activities, including: fraud investigations, where lenders have lost money as a result of inaccurate financial statements; patent infringement cases; and shareholder disputes, especially with respect to junior shareholders, and minority shareholder buyouts and items of that nature, where people feel they're not getting their fair share.

The firm has also taken on cases involving director-officer litigation, where stock prices are dropping; class action lawsuits, where various alleged deception has occurred and they've had to go to trial; charity situations where the books have been allegedly tampered with and people are taking money from those organizations; offshore operations; and a growing number of Ponzi schemes.

For example, notes Rosen, "Look at Sino-Forest. Why did they come to Canada when the trees, and so on, were supposedly in China. The money was not coming from selling fictitious trees. This was a recirculation of the money that was raised in Canada as capital. It was a massive Ponzi scheme.

"Contempt for Canada's ability to control white collar crime I think [is] the real issue," said Rosen, who cites cases such as Nortel and Bre-X as warning signs that should have dented what he claims is a false sense of security held by many Canadians.

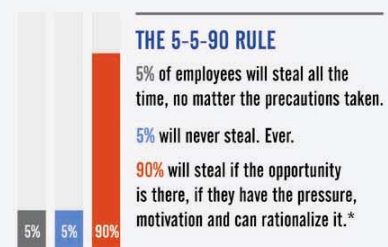
### WHY **FORENSIC ACCOUNTING** IS NEEDED



TO COMMIT OCCUPATIONAL FRAUD THERE MUST BE A COMBINATION OF THREE ELEMENTS



**80%** of occupational losses are attributable to dishonest employees.\*



The higher the position of the perpetrator, the greater the financial loss, but the less likely due to higher security measures.\*

Who's responsible for fraud in your company?

**EVERYONE**

\* Earl Basse, CMA, FCMA

While there is an honest group in society who won't take advantage of situations to steal money, there are enough people who are dishonest that one has to be on their toes, warned Rosen. "What we see coming out of accountants today is a naïve belief that if you follow the rules everything is OK. If you have a belief that all Canadians are honest and not touched by these things, that's just terribly naïve," he concluded.

In fact, occupational fraud – to use one major example of the work forensic accountants are called in to investigate - is a huge problem worldwide. The Association of Certified Fraud Examiners, the world's largest anti-fraud organization, headquartered in Austin, Texas, estimated that annual fraud loss globally was more than U.S. \$3.5 trillion in 2011.

The classic fraud triangle theory, which states that a combination of three elements: financial motivation, opportunity, and the ability to rationalize theft all need to be present to commit occupational fraud, hasn't really changed over the past several decades, said Earl Basse, CMA, FCMA, a forensic accountant based in Waterloo, Ont.

"There are some myths that a lot of people have, particularly in small and mid-sized businesses. The first myth is they believe 'it can't happen here, because our people are honest and would not commit fraud against us.' One of the teaching rules we use is a 5-5-90 rule. Five per cent of your employees will steal from you all the time, no matter what you do. Five per cent will never, ever steal from you. [And] 90 per cent will steal if the opportunity is there [if] they have the pressure; the motivation; and they can rationalize it. So you have to minimize those [elements] - particularly the opportunity," said Basse.

Employees are the best source of information to determine if fraud is happening inside the corporation, said Basse.

"To me, awareness is the key. When you get awareness amongst your employees - not only security awareness, but anti-fraud awareness, and you have things like whistle-blower hotlines, where you have ease of reporting issues, that's when you get a lot more reports of internal theft and fraud to management and things like that," he added.

It helps, too, that whistleblower hotlines have been put in place in Canada and the United States, as required by law, and that they don't have the negative 'snitch' connotations they may have had in the past, noted Basse, who said 80 per cent of occupational fraud losses are attributable to dishonest employees.

Basse said the higher the position of the perpetrator, the greater the financial loss. However, he also stated the likelihood of occupational fraud is probably less at very senior levels because there's usually a much better background check when a senior executive is brought in since it's often conducted by a professional search firm.

"I find that it's mostly mid-management, usually between [the ages of] 35 and 50, where they have the authority to really circumvent the internal controls. There are often external issues - gambling perhaps, drug habits that they need the money for, and the company pays for it," he said.

And it often starts innocuously. "A lot of people, when they first start doing this don't do it because they're dishonest. Say it's coming up near Christmas. They want to get their son an

extra toy or some sort of computer program or game which costs them \$200. They don't have it, so they borrow it from the company because they [intend to] pay it back," Basse noted.

"But then spring comes and they haven't paid it back yet, and they need a little more because they're going on a vacation, [and figure] I'll borrow another \$100, \$200, \$500. Eventually, it gets to a point where they can't pay it back; it's too much. And so it becomes a habit, and they keep doing it," he added.

Forensic accountants look to a firm's internal controls as a strong indication of how effective it may be at preventing occupational fraud.

A lot of times internal controls are weak because the company has let them go for a long time. They haven't reviewed or tested them to ensure they remain strong and cannot be circumvented by management. Or perhaps one person has too much authority, rather than having a situation where two or more employees split duties in areas such as cash procedures and inventory controls, Basse stressed.

Forensic accountants need to emphasize to their clients that the tone has to come from the top. "Executive management has to not only possess integrity, but demonstrate it and support it all the way down the line," said Basse.

They also need to encourage their clients to undergo a thorough vetting process during hiring, including conducting criminal checks. While it's clear that no employer would ever intentionally hire a thief, it's hard to tell who is likely to become one. "You'd be absolutely amazed the number of companies that don't do background checks on their employees, and if they do a background check it's very superficial. They rely only on references," said Basse.

Forensic accountants also need to encourage their management clients to be proactive about preventing fraud.

"One of the questions I ask when I'm giving presentations is 'who is responsible for fraud in your company?' A lot of the answers I get are 'it's the president, the security manager, or the head of this or that,' when in fact, it's everyone. If you want to keep your company viable and everyone has a place to work, then everyone has to be aware of it. That comes down to [establishing] a formal fraud awareness program in the organization," said Basse.

Occupational fraud will continue to get worse before it gets better, predicted Tom Warren, a principal with Net-Petrol Internet Incorporated in Burlington, Ont.

"It would be a wonderful thing if [firms] could pro-actively get on it, but many don't take in that cost of thinking to be pro-active," he said. "Companies are wise to utilize the skills of the forensic accountant, and the forensic data examiner in order to safeguard themselves. Accountants can address the risk, including the cost of [that] risk," he said.