

So What Is Forensic Accounting?

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Although forensic accounting is not a new discipline, it is one that is rapidly developing and gaining status in the accounting and legal communities. The media have been energetically covering accounting scandals and intrigues, which are often characterized as the forensic accountant's "beat. If the number of articles written on the topic is any indication, readers of such esteemed newspapers as *The Wall Street Journal* and *The New York*

Times are captivated by the forensic accounting topic. The good news for accounting professors and students is that if current trends persist, forensic accounting and its many subspecialties will provide some very interesting and lucrative career opportunities.

Forensic Accountants Are Hot!

Accountants, long the butt of bean-counter jokes, are viewed a bit differently these days. Major scandals such as Enron, WorldCom, and Bernard Madoff certainly have tarnished the image of the accountant, but the "forensic accountant is getting a lot of respect. Gordon Brown, the then British Chancellor of the Exchequer, on October 10, 2006, said that "what the use of finger prints was to the 19th century and DNA analysis was to the 20th, forensic accounting will be to the 21st century."

After the terrorist attacks of September 11, 2001, it was determined that a number of the perpetrators used debit cards that had been set up by cash—largely untraceable—brought into the country. There were even some transactions with no moving money, possibly using offsetting receivables and payables, that were still traceable.* The FBI agents employed forensic-type techniques when looking at credit cards, phone records, and interviews with terrorists' neighbors and friends. Shutting down the cash flowing into the terrorists' network was accomplished using financial sleuths.

Accounting also made the big screen, and its new notoriety has been satirized in the popular media. A short film entitled *The Accountant* won an Academy Award in March 2002. The hard-drinking, chain-smoking backwoods movie accountant cynically states that "numbers and facts are already fudged here and there; it's called accounting. A Jack Ziegler cartoon in the March 10, 2002, *New Yorker* magazine shows a couple of women at a bar with one telling the other that "being an accountant gives him that extra aura of danger.* The AICPA now has an online game called "Catch Me If You Can"* which allows students and professors to use their skills and smarts to trace the money trail back to the crooks. There is a \$2,000 cash prize plus other prizes.

These may be some unwelcome visions of accounting, but they point out that accounting—and forensic accounting in particular—is not only noteworthy, but newsworthy. In light of the

notoriety and scandals, one movie analogy does seem appropriate: Similar to the agents in the film *Men in Black*, the forensic accountant's armory must be equipped with talent to suit every purpose, from detecting cooked books, to kiting, to money laundering. As Al Pacino said in the movie *The Recruit*, "Things are not what you think they are."

Forensic accounting is a challenging discipline that substantially interacts with auditing, economics, finance, information systems, and law. Terry McCarthy, audit partner with Green & Seifert, "likens it to 'CSI' or 'Law & Order,' but instead of figuring out the trajectory of a bullet, you're trying to find out how a transaction occurred."*

Defining Forensic Accounting Broadly

Many people believe forensic accounting and fraud auditing are synonymous. They are not. A fraud auditor is an accountant specially skilled in auditing who is generally engaged in auditing with a view toward fraud discovery, documentation, and prevention. A forensic accountant may take on fraud auditing engagements and may in fact be a fraud auditor, but he or she also will use other accounting, consulting, and legal skills in broader engagements. In addition to the accounting and investigative skills that should certainly be present in the fraud auditor, the forensic accountant needs a working knowledge of the legal system and excellent quantitative analysis and communication skills to carry out expert testimony in the courtroom and to aid in other litigation support engagements.

Bruce Dubinsky, a partner in Klausner, Dubinsky & Associates, stresses their broad approach by emphasizing that there are plenty of accountants getting involved who should not be involved in the niche. "The only limit to our size is finding competent professionals." He explains that just being an accountant is no longer enough to do this work—the person has to understand the legal system, and what the law says. How to interrogate and interview people are musts. Tracking leads and obtaining legally usable intelligence is also crucial. "Many accountants think it is simply fraud investigation and it's not. It really is much more than dealing with the numbers. It's no longer just basic fraud work."*

Robert Overbaugh, a partner at Pittsburgh-based Sisterson & Co., is more blunt. He asserts that "forensic accounting is often thought of, in somewhat narrow terms, as dealing with the investigations of fraud or financial misconduct. His firm thinks in broad terms and performs engagements in most areas in which attorneys use financial experts in litigation and disputes.* To put it another way, a forensic accountant reduces the complexity by distilling information and slicing away deceptions to help a judge or jury to see the essence of a financial dispute.*

Forensic accountants provide perspective in situations evaluating whether accounting information is presented fairly without GAAP-based constraints, such as:

- Identification of financial issues.
 - Knowledge of investigating techniques.
 - Knowledge of evidence.
 - Interpretation of financial information.

- Presentation of finding.*

James Edwards, the publisher of the *Journal of Forensic Accounting*, champions this broad definition rather than the narrow fraud examination definition. He believes that forensic accountants are employed to seek, interpret, and communicate transactional and reporting event evidence in an objective, legally sustainable fashion, not only in situations in which there are specific allegations of wrongdoing, but also in situations in which interested parties judge that the risk of loss from wrongdoing is such that proper prudence requires legally sustainable evidence to support the conclusion that no wrongdoing is occurring.

Concisely defined, *forensic accounting* is the use of accounting for legal purposes. Hal Rosenthal gives the modern definition of forensic accounting as “the use of intelligence-gathering techniques and accounting/business skills to develop information and opinion for use by attorneys involved in civil litigation and give trial testimony if called upon.*

Distinction Between Forensic Audit and Financial Audit

A forensic audit is often different than a typical financial audit. A financial audit is generally a sampling activity that does not look at every transaction. Thus, the system can be exploited by someone, such as an executive, who knows how to “cook the books.”

A forensic audit looks at the details of a specific aspect of the records, trying to determine why everything does not or should not add up. Thus, a forensic audit is much more time-consuming and can be significantly more expensive than a regular financial audit.* Doug Carmichael, former Chief Auditor for PCAOB, faults auditors for not adopting forensic techniques. He prefers more tests of detail rather than relying on tests of controls.*

Ronald L. Durkin suggests the following differences in a forensic audit versus a traditional audit:

- Not limiting the scope of the engagement based upon materiality.
- Not accepting sampling as evidence.
- Not assuming management has integrity.
- Seeking the best legal evidence.
- Melding the requirements of the evidential matter standard with the rules of evidence.*

Two practitioners have suggested these additional procedures may be used in a forensic audit:*

- Extensive use of *interviews* and leveraging techniques designed to elicit sufficient information to prove or disprove a hypothesis.
- Document *inspection* that may extend to authentication procedures and handwriting analysis.

Forensic Accountants in Novels

In general, forensic accounting can be broken into two broad categories: investigative auditing and litigation services. A series of fictional novels involving the financial and investigative

intrigue of fraud portrays a forensic accountant as the hero and illustrate these two broad areas. The novels place Professor Lenny Cramer in exotic locations with colorful characters and surround him with murders and crime. Some of the plots include "track[ing] foreign receipts to uncover a plot to steal Burmese religion treasures...conducting an audit at Coca-Cola [and] uncovering a scheme to steal the company's secret formula...[and using] his forensic accounting skills to solve a series of murders in the New York art world."*

A more recent novel teaching forensic accounting entitled *The Big R: A Forensic Accounting Action Adventure* provides a description of the forensic accountant character called Fred Campbell.*

Now he did more than just disputed divorce-settlement work. His areas included antitrust analysis, general consulting, and cost allocation. Anytime someone had to dig into the books and records, he was available. Super Accountant Campbell! Maybe he should get a special cape to wear like Superman. Or was that batman? He packed a HP 12-X pocket calculator and a notebook computer. He thought of himself like the forensic anthropologist in a Patricia Cornwell or Kathy Reichs novel.

Lenny Cramer shows up in a new novel entitled *Trap Doors and Trojan Horses: An Auditing Action Adventure*. Espionage and fraud place Lenny's life on the line as he uncovers a scheme to steal Coke's secret formula. The story features a variety of settings, from Washington, D.C. to Poland. The suspenseful story combines computer and auditing concepts in a fashion even a novice can understand and enjoy.*

Behavioral Concepts

A key element of a forensic accountant knowledge base is behavioral concepts. Some fraud schemes cannot be effectively detected using data-driven approaches. Corruption schemes such as bribery, kickbacks, and bid-rigging may go undetected using data-driven techniques. Searching relevant transaction data patterns and unexplained relationships often fail to yield results because the information may not be recorded by the system.

Just like an IRS agent, a forensic accountant should be aware of the lifestyles of employees of companies as well. The lifestyle of a taxpayer or employee may give clues as to the possibilities of unreported income. Jack Bologna and Robert Lindquist* refer to this approach of looking at events, transactions, and environments in their covert aspects. They believe that fraud auditing is like an iceberg with many of the behavioral, covert aspects of the fraud below the water line, including:

- Attitudes
- Feelings (fear, anger, etc.)
- Values
- Norms
- Interactions
- Supportiveness

- Satisfaction

Of course, many of the structural, overt aspects are important, but the behavioral aspects below the surface can be extremely important. For example, a great deal of information about fraud can be found by listening, especially around the copy machine or break room (or wherever the employees congregate on breaks). Stakeouts and sifting through garbage may be off-beat ways to gather evidence. Interviewing peers, workers, and neighbors may be helpful. Further, in addition to examining financial documentation, a forensic accountant must focus on the individuals involved by interviewing witnesses and suspects.

Niamh Brennan and John Hennessy state that forensic accounting demands an awareness of motive. "Often a pattern of evidence only becomes apparent and understandable when the forensic accountant considers possible motive."* Robert J. Lindquist states: "You've got to have knowledge of fraud, what it looks like, how it works, how and why people steal. You're the bloodhound much more than the watchdog."* Sandi Smith says that often a suspect's lifestyle will give him or her away. "Forensic accountants can study computerized banking records, tax records, and the employee's human relations department records to create an individual profile."

Certainly, obvious lifestyle changes may indicate fraud and unreported income:

- Lavish residence
- Expensive cars and boats
- Vacation home
- Private schools for children
- Exotic vacations

However, the investigator must keep in mind that a high-living style may be obtained by going into debt or through "family money" such as gifts and inheritances.

Conclusion

In today's climate all accountants – external, internal, corporate accountants, and yes, the forensic-accounting specialist – must develop forensic competencies. I believe it will only be a matter of times before most accounting majors will take one or two forensic-type courses.

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