INTEGRATING FORENSIC ACCOUNTING

By Susan Koss

People are intrigued when I tell them I am a forensic accountant. High profile cases like Bernie Madoff and Enron come to mind immediately for many people. These cases have spotlighted several things including the need for increased accounting regulation but also the need for forensic accounting services.

So what exactly is forensic accounting?

Forensic accounting is the integration of accounting, auditing and financial skills with investigative techniques and professional skepticism. Experience in the business world in positions such as staff accountant, controller or Chief Financial Officer is also pertinent. Relevant experience investigating irregular transactions and the ability to question something that just doesn't seem right are special talents. Forensic accountants must have good communication skills and healthy skepticism in order to effectively interact with parties involved as well as communicate findings and opinions in a clear and concise manner. The culmination of all these skills is integral to solving the puzzle that is the core of forensic accounting.

People sometimes confuse the role of an auditor with a forensic accountant. Because the role of auditors focuses on reasonable assurance that financial statements are free of material misstatements, they test financial transactions on a sample basis. An auditor reviews the books and records for reasonableness. A detailed review of the nature of every transaction is not the goal of an audit.

However, in a forensic accounting investigation, materiality is not a factor and does not impact the scope. Consequently, sample testing is generally not done in a forensic investigation. A review of all records for a time period is typically performed to determine trends and identify patterns. Transactions of all sizes can be reviewed. In fact, even the smallest transactions can lead a forensic accountant to a potential fraudulent scheme.

Forensic accounting services are performed for matters involving shareholder disputes, marital dissolutions, economic damages, fraud and white-collar criminal investigations, breach of fiduciary duty, professional negligence and bankruptcy among others. Shareholder disputes are very prevalent and frequently driven by an imbalance of power between the non-controlling and controlling shareholders or a stalemate among equal owners.

For example, a non-controlling shareholder may want a buyout of his/her interest and understands that to get to the true value potential issues must be addressed first such as:

- **Excessive compensation and benefits paid to the controlling shareholder**
- **Personal expenses of the controlling shareholder, such as automobile, travel and entertainment, paid by the company**
- **Diversions of funds from the business to related parties of the controlling shareholder or payments to ghost (non-existent) employees and to fictitious vendors**
- **Diversions of business opportunities for the benefit of the controlling shareholder to the detriment of the non-controlling shareholder**
- **Non-payment of dividends or payment of inadequate dividends.**

Such issues of concern often come to light in these types of engagements. The forensic accountant can determine the validity and extent of such issues by not only looking at the numbers but looking behind them as well. The forensic results could also uncover hidden assets, identify unreported income, or determine lost profits. Ultimately, a forensic accountant with solid experience, accounting and financial analysis skills can be invaluable in investigating and quantifying financial damages, but just as importantly, must be able to effectively and persuasively present his or her findings to the trier of fact.