

Excerpts from “Business; And Now, a Case for the Forensic Accountant”

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SOMETHING struck Paul Morsen as odd about a trash hauler's request that the Central Contra Costa Sanitary District approve higher rates for customers to keep it out of bankruptcy. After all, just weeks earlier, this trash hauler, Orinda-Moraga Disposal Service Inc., said it could lower the cost of collecting garbage for customers. "Both those things can't be true," because no rational company offers to cut prices when it is losing money, said Mr. Morsen, who at the time -- the summer of 1996 -- was deputy general manager of the Sanitary District.

So he called in a forensic accountant, Dan W. Ray. Mr. Ray's profession is a bit of an oxymoron. The very word forensic sounds glamorous and perhaps a little scary -- forensic psychology seems to crop up in conversations about Thomas Harris's fictional cannibalistic shrink, Hannibal Lecter; forensic pathologists helped identify the deceased victims of violence in Argentina and the former Yugoslavia.

At the same time, accounting is renowned for being, well, a snore. Not this kind. As the economic climate has worsened and investors have started prowling restlessly for evidence of past corporate sins -- overstated costs or revenue, for example, or understated inventory -- forensic accounting is in demand.

It is difficult to tell how great the demand is, though -- clients of forensic accountants do not usually want to advertise that they lost track of money they now have to find. But, to name just a few recent cases, Xerox is using accountants to investigate its finances and Cendant hired Arthur Andersen to sort out possible accounting irregularities in the wake of fraud accusations that surfaced last year.

Forensic accounting experts are also hired by defendants in fraud cases. Lawyers for Albert J. Dunlap, the former Sunbeam Corporation chairman and chief executive accused this month by the Securities and Exchange Commission of accounting fraud, hired forensic accounting experts at PricewaterhouseCoopers to examine Sunbeam's books.

STRICTLY speaking, forensic accounting is audit work performed to help in litigation, but it usually refers to the investigation of an individual's or a corporation's finances to find missing money. The practice is not limited to big accounting firms like PricewaterhouseCoopers and Deloitte & Touche, though they are expanding their business. Many small firms and solo practitioners are out there, too.

There is no typical case of fraud, but the Contra Costa trash story illustrates how forensic accountants work. The first thing Mr. Ray did was check a database to see whether William D. Lomow, the owner of the trash hauler, owned other California companies that could be involved in any scheme. It turned out that he did. So early in the investigation, which was allowed by the terms of the contract between the sanitary authority and the trash company, Mr. Ray asked Mr. Lomow whether he owned any other companies. "He said no, and that was the wrong answer," Mr. Ray recalled. "It told me I was dealing with someone who wasn't truthful. I describe it as my 'litmus test of management integrity.' And he failed."

Alerted that the owner was probably hiding something, the accountants reviewed payments the company made, and found a check payable to a Bay Area company deposited in a bank in Boise, Idaho, where Mr. Lomow had a personal account.

Mr. Ray checked the name of the owner of the company that made the deposit and found that the same person -- who, it turned out, did not exist -- owned other companies. All were recipients of checks from the trash company, all were founded on the same day, and all had fictitious business addresses, such as a Mailboxes Etc. outlet in Berkeley, Calif., a vacant building, or a Post Office drop box, Mr. Ray said.

It turned out that the other companies, supposedly providing maintenance services for garbage trucks, were dummy corporations established by Mr. Lomow to siphon money from the trash company, Mr. Ray said. Mr. Lomow overstated costs to justify rate increases, and then the payments made by the company went straight into bank accounts under his control, Mr. Ray said.

The trash case is unusual in that most of the details became public. Usually the clients of forensic accountants prefer to keep all information secret, so they do not publicize their vulnerability to fraud. Many of the stories that the accountants tell are therefore vague.

Forensic accountants often get called in to help with more mundane matters, like divorces. Wealthy spouses often go to extraordinary lengths to hide assets so they are not consumed by alimony payments, and accountants may have to pore over bank and real estate records to find them.

When a publicly held company is involved, or the case receives significant attention, it is sometimes important to the client to send a message that cooking the books will be punished. In order to do that, the victim of fraud may turn over all the information uncovered by a forensic accountant to prosecutors, who may bring criminal proceedings against the culprit, as in the Contra Costa trash case.