

Forensic Expertise and Corporate Collapses

CPA Australia

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Overview

- Turn of the century corporate collapses
- The development of APES 215 *Forensic Accounting Services*
- GFC related corporate collapses
- Forensic Accounting Services
- Madoff scandal
- APES 225 Valuation Services
- Key APESB Standards of Interest

Turn of the century corporate collapses

- Examples of corporate collapses (refer Table 1)
- Increased regulations such as CLERP 9 in Australia and Sarbanes & Oxley in the US

Table 1: Corporate collapses (circa 2000/01)

Company	Problems	Losses to shareholders	Job losses
WorldCom	US \$ 4.3 billion overstatement of earnings and \$11 billion in assets	\$ 179.3 billion	30,000
Enron	Inflation of income, assets, bankrupt 2001	\$ 74 billion	6,100
Waste Management	Overstatement of income by US \$ 1.1 billion, (1992 -96)	\$ 20.5 billion	11,000
Sunbeam	Overstatement of 1997 income by US \$ 71 million then bankruptcy	\$ 4.4 billion	1,700

Source: "Fall from grace," *Business Week*, 2002

Worldcom



WHAT HAPPENED

Inflated assets by as much as **\$11 billion**, leading to 30,000 lost jobs and \$180 billion in losses for investors.



MAIN PLAYER

CEO Bernie Ebbers

HOW HE DID IT

Underreported line costs by capitalizing rather than expensing, and inflated revenues with fake accounting entries.



HOW HE GOT CAUGHT

WorldCom's internal auditing department uncovered **\$3.8 billion** in fraud.



PENALTIES

CFO was fired, controller resigned, and the company filed for bankruptcy. Ebbers **sentenced to 25 years for fraud**, conspiracy and filing false documents with regulators.



FUN FACT

Following the scandal, Congress passed the Sarbanes-Oxley Act, introducing the most sweeping set of new business regulations since the 1930s.



Enron



Paper shredder: **\$100**

Debt hidden in off-balance-sheet subsidiaries:
\$500 MILLION

Stock cashed in by executives while encouraging
employees to keep buying: **\$1.3 BILLION**

Sitting it front of a congressional committee and
claiming ignorance of any wrongdoing with a
completely straight face: **PRICELESS**

*There are some things money can't buy.
Integrity is one of them.*

The demise of Arthur Andersen

"NOBODY COOKS LIKE ARTHUR ANDERSEN"

- Joseph F. Bernardino, CEO of Arthur Andersen



ANDERSEN GRILL



The development of APES 215 *Forensic Accounting Services*

- Original APES 215 was based on APS 11 and GN 2 (issued 2002)
- APES 215 extended the scope to *Members in Business* from **1 January 2009**
- In 2011, stakeholders requested that APESB clarify the application of APES 215 to **Members in Business** and the **different types** of *Forensic Accounting Services*
- Revised APES 215 operative on or after **1 April 2014** with early adoption permitted
- APESB will soon be releasing another Revised APES 215 which will be operative from 1 April 2016.

GFC related corporate collapses

- Recent corporate collapses brought on by the Global Financial Crisis (refer Table 2)
- Inside Job – Official Trailer

<http://www.youtube.com/watch?v=FzrBurlJUNk>

Table 2: Recent Corporate collapses due to the Global Financial Crisis

Company	Problems	Business/Social impact
Lehman Brothers	<ul style="list-style-type: none"> - Derivatives : MBS and ABS - Downgrading of credit ratings - Toxic commercial real estate assets - High leverage ratios 	<ul style="list-style-type: none"> - Majority of the 26,000 worldwide staff made redundant?
Bear Stearns	<ul style="list-style-type: none"> - Derivatives : MBS and ABS - High leverage ratios - Unrealistic fair value accounting of assets 	<ul style="list-style-type: none"> - Approximately 9,000 employees lost their jobs - Shareholder lawsuits?
ABC Learning	<ul style="list-style-type: none"> - Revenue recognition - Gearing - Weak corporate governance 	<ul style="list-style-type: none"> - 241 unprofitable day care sites for sale - Unemployment - Child care services at risk?
Opes Prime	<ul style="list-style-type: none"> - Cash and share movement irregularities - Failed margin calls 	<ul style="list-style-type: none"> - Losses of AUD 600 million?

Source: www.google.com

Forensic Accounting Services

Types of Forensic Accounting Services:

- Expert witness
- Lay witness
- Investigation services
- Consulting expert

Examples in Appendix 3 of APES 215

Traits and core skills of a Forensic Accountant

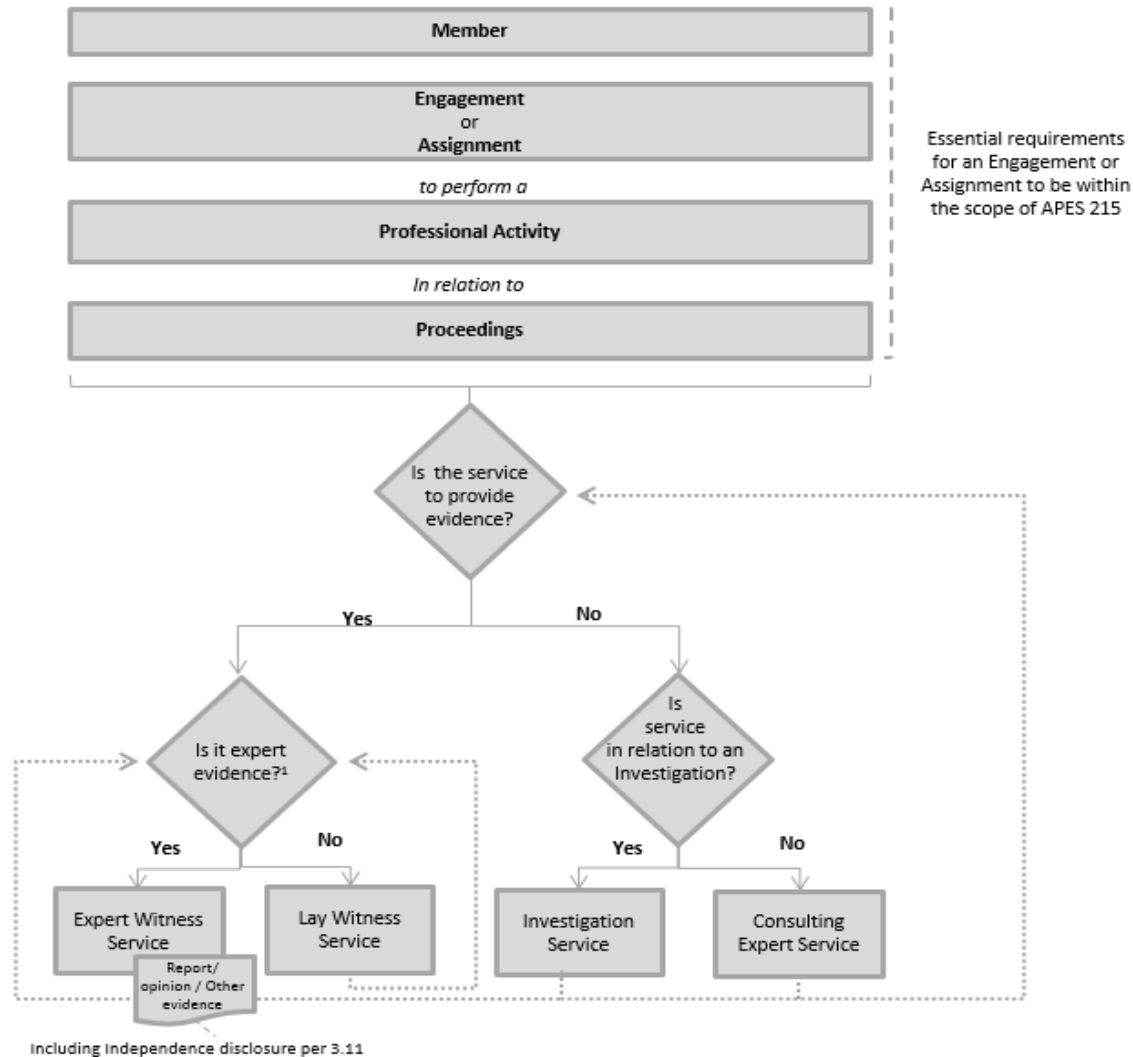


Scope of APES 215

- Key requirements for a matter to be within the scope of APES 215
 - Member who is engaged or assigned to perform a *Professional Activity*
 - The *Professional Activity* is in relation to a *Proceeding*

- Determination of the type of *Forensic Accounting Service*
 - Depends on whether the service is to provide evidence to the Court
 - Is it in relation to expert evidence or in relation to an investigation?

Scope of APES 215 (Appendix 2)



¹ Whether or not evidence is accepted as expert evidence is an after the fact matter. A Member must comply with the Standard in anticipation that evidence will be treated as expert evidence.

Madoff scandal



The Fraud of Bernard Madoff



Bernard "Bernie" Madoff

Born in the New York City borough of Queens, on April 29, 1938.

Sentenced on June 29 to 150 years in prison, pled guilty to an 11-count criminal complaint, admitting to defrauding thousands of investors of billions of dollars. He was convicted of operating a Ponzi scheme that has been called the largest investor fraud ever committed by a single person.



The countries affected by the fraud

Total cost of the fraud

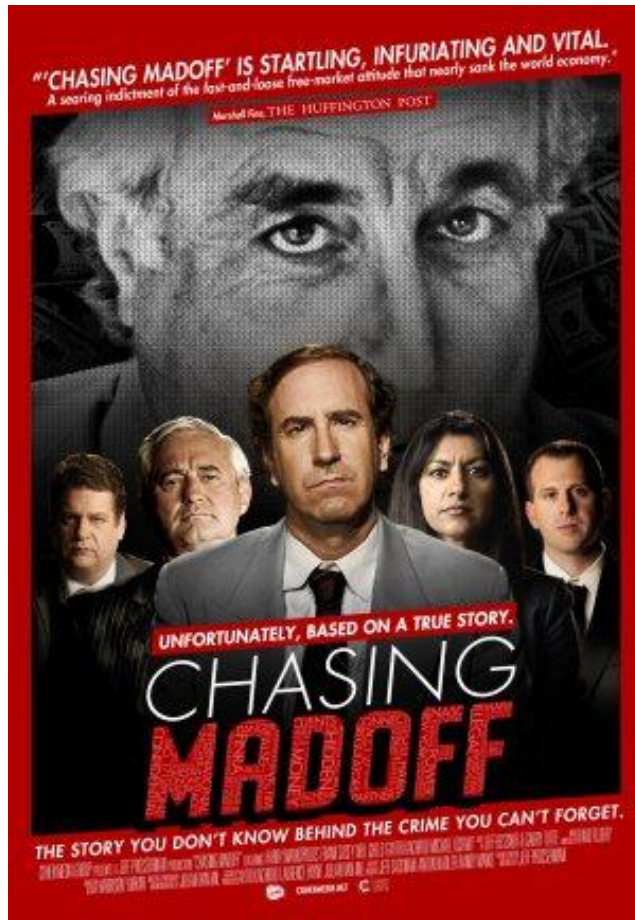


Number of years sentence for those involved

- 25 years**
Bernie Ebers World comm Chief
Jeff Skilling Enron Chief
- 20 years** Tim Rigas
Chief of Adelphia communications

source: http://www.nytimes.com/2009/07/10/business/10madoff.html?_r=1&sq=madoff&st=ec | <http://business.timesonline.co.uk/eol/business/ins/article5733960.ece> | <http://www.bbc.com/news/central-america-5368409-madoff-screwed-the-entire-world-made-of-sand-made-out>

Chasing Madoff



<http://www.youtube.com/watch?v=62L7VxMDg68>

Chasing Madoff – A few red flags

1. Split-strike conversion strategy with options
2. Market timing of when to invest
3. Giving up profits while he did most of the work
4. It was cheaper to borrow
5. Secrecy demanded from investors
6. Performance line had a 45 degree angle

Consequences of fraud

Senator Ackerman on Madoff Fraud

http://www.youtube.com/watch?v=FOKSkaQoF_I



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MADOFF BEHIND BARS... DAY ONE

A courageous forensic accountant...

Harry Markopolos – Independent Financial Fraud Investigator & Analyst

- Warned the US SEC's Boston office in May 1999.
- Submitted an eight page document listing red flags to the Boston Office in May 2000.
- At the time Madoff fund was estimated at US\$7-10 billion.
- Resubmitted evidence to U.S. SEC Offices in 2001, 2005, 2007 and 2008.
- The 2005 report documented 29 red flags, at which time the Madoff fund was estimated at US\$20-50 billion.
- The final loss in excess of \$100 billion

http://www.youtube.com/watch?v=uw_Tgu0txS0

APES 215 Forensic Accounting Services

The examples in appendix 3 cover a wide range of circumstances such as:

- Expert Witness Services
- Professional tribunals
- Dispute meditations
- Investigations by law enforcement/regulatory agency
- Member in Business employed by a company which is being investigated
- Insurance claims
- Family law
- Members providing affidavits
- Members employed by a revenue authority

APES 225 Valuation Services

- Revised in May 2012
- Mandatory for the Members of the three Professional Bodies
- Effective for Valuation Engagements or Assignments commencing on or after 1 September 2012
 - All Members who provide an estimate of value for a business, business ownership interest, security or intangible asset are required to comply with APES 225

Revision of APES 225 in May 2012

- Materials added:
 - Schematic on the determination whether a professional service constitutes a Valuation Service and which type
 - 8 additional examples of various Valuation Services provided by Members (23 examples in total)

Key APESB standards of interest

- *APES 110 Code of Ethics for Professional Accountants*
- *APES 215 Forensic Accounting Services*
- *APES 225 Valuation Services*
- *APES 330 Insolvency Services*

Next steps...

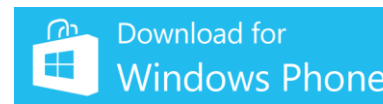
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Q & A session...