

Everyone knows that accounting irregularities haven't disappeared. In fact, more than 500 anonymous tips on corporate accounting irregularities have recently been pouring into the Securities and Exchange Commission's Web site each month, says Simon Platt, Deloitte & Touche LLP's national director of Forensic and Investigative Services. In addition, he says, 20 percent of American corporations are likely to have changed auditors this year.

It has been a busy year for Platt, who regularly gets called in when unexpected corporate losses lead to board-level investigations. The Boston-based accountant's basic tools include not only employee interviews and close examination of balance sheets and sub-ledgers, but sophisticated investigative techniques not unlike those used by the FBI.

"One of the first things that we do is to take virtual copies of all the hard drives of key employees — personal laptops included," says Platt, "Then we scan these hard drive copies for certain key word phrases. You would be amazed at what the average corporate executive will say via e-mail — stuff that would normally never make it on to paper. And yet e-mail correspondence tends to be much easier to retrieve and examine than paper ever is."

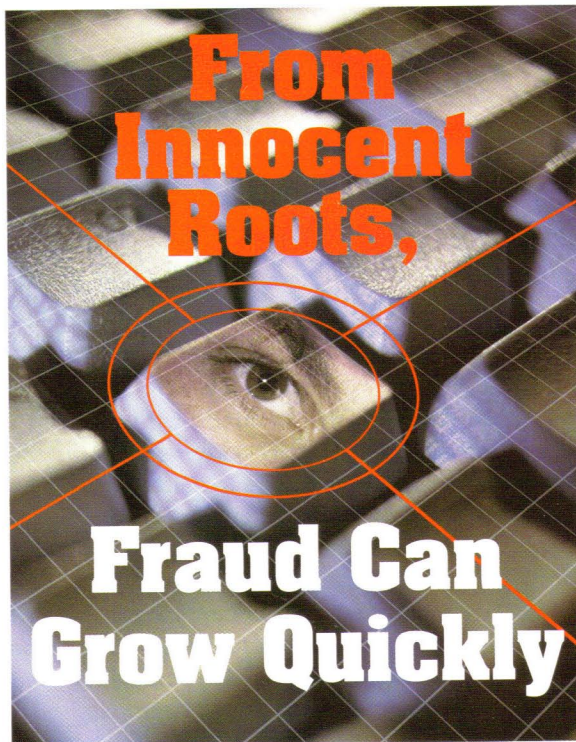
According to Platt, once forensic accountants like those at Deloitte get called in, wrongdoing tends to be unearthed in about 98 percent of cases. Sometimes this is just mild earnings manipulation, and less often actual fraud, but "distinguishing between the two of these is certainly an art, not a pure science," Platt says.

The FBI has estimated that the chances of actually being prosecuted for corporate fraud are 20,000-1. This is because a prosecutor must not only find accounting misstatements, but then must prove that there was actual intent to deceive, and not a simple

error or oversight.

Given such a low probability of getting caught, it may be unsurprising that 68 out of 100 major corporate CFOs responded "yes" when asked anonymously at a 1998 BusinessWeek conference: "Has your CEO ever asked you to falsify financial results?" Twelve percent of the CFOs admitted to committing the falsification.

And from whence does most of



By Barclay T. Leib

this malfeasance spring? "It almost always starts very innocently," says Michael Young, a New York-based litigation partner for Wilkie, Farr & Gallagher. "Far and away, most executives are honest and decent people. But problems usually start when these same people are put under undue pressure by senior management. If the tone at the top of an organization is that failure to meet a quarterly sales or return target would be 'unforgivable,' then line managers often feel forced to enter the 'gray zone.'"

The "gray zone" comprises such techniques as: shipment acceleration

(sometimes known as "channel stuffing"); swapping equity for revenue; creative acquisition accounting; the lowering of reserves for merchandise likely to be returned; bill-and-hold arrangements (often with side letters guaranteeing the right to return goods); the raising of pension fund return assumptions; and "round tripping" of revenue between companies.

"Round tripping" is getting considerable SEC attention. It happens when two companies swap goods at inflated values, often with a so-called "bounce-back wiring of funds" in order to push up their respective revenues, although total net corporate profits re-main unchanged.

"When a company resorts to just one or two of these techniques, it can seem very innocent to people involved at first — something used as a temporary measure to smooth over a rough quarter," says Young. "But on a cumulative basis, such situations just tend to get worse and worse until a 'big bath' write-off must eventually be taken.

"Once a company is forced to come clean with one earnings restatement or write-off, be prepared to see earlier quarters restated as well," adds Young.

Ironically, the hallmark of corporations susceptible to accounting fraud — aggressive and unforgiving senior managements — is common to some of America's top corporations. "That's what makes spotting fraud particularly difficult," says Platt. "Corporate executives generally have to be tough to be successful, but they can't put employees in 'do or die' types of situations without the risk of having pushed too hard."

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