

## **At the cutting edge**

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**Forensic accountants are experts that get to the financial bones of legal, regulatory or investigative processes and discover the cause of any major problems, slicing through financial information and getting answers from numbers. Andrew Mainz and Tom Battell explain**

Accountants are rarely welcomed with open arms into the insurance fraternity and, indeed, many insurers hold the stereotypical view that a 'tick and bash' audit mentality has never improved the bottom line for insurers. However, there is one class of accountant that is relied upon when dealing with complex issues requiring extraction and analysis of mass data into an understandable format - the forensic accountant.

So what exactly is a forensic accountant? Simply an accountant that works on the financial aspects of any legal, regulatory or investigative process.

Rather than use scalpels or fingerprinting equipment, the tools of their trade are an investigative nature, analytical mind and an ability to focus everything down to a range of numbers.

Most of us are aware of the help forensic accountants provide in business interruption claims. Tearing the figures apart after a wildly optimistic claim is submitted or assisting both insurer and policyholder in giving an early 'heads up' on the financial implications of any particular course of recovery action (and avoiding the consequences of taking the wrong financial steps) are well-known examples. To this might be added calculating the loss of revenue from a train derailment or the throughput reduction from a factory fire.

A lesser known application is in the area of financial loss where accountants are used in connection with the

investigation of directors' and officers' insurance claims or auditor professional negligence. Many incidents relate to the preparation of accounts - a growth area for claims - for example Enron, Andersons or any of the high profile stock exchange collapses.

Underwriters need to know why the accounts were wrong and if they were prepared fraudulently or just negligently, because insurance only becomes involved in the latter case.

To reach a supportable conclusion on this issue, it is essential to understand who prepared the accounts and how they went about their work. For example, in the case of the excessive valuation of energy reserves by Shell, how much did the directors actually know about the treatment of its reserves in its accounts and who made the key decisions? Were the auditors complicit in their acceptance of the figures? And what prudent measures were undertaken to probe these? Investigating the preparation of the accounts in a focused way is the real skill of the forensic accountant.

Some believe the auditors themselves can investigate this but the auditor's position is compromised whenever there is a claim - they have everything to certify before the event and everything to defend thereafter. Certainly, after the accounts are published, they cannot independently investigate even if they bring in a separate team of forensic accountants from their own practice - an independent party is needed.

Accountants have a natural affinity with the area of computer forensics.

Figure work and mass-data analysis are core skills and the opportunity to unpack hidden financial misdemeanours is a hard one to resist. The retrieval of deleted and seemingly unconnected electronic data, in a manner that is evidently acceptable, is of value when allied to an ability to analyse and recreate the intentions of a 'scam' that is financially motivated.

Another forensic accounting specialism is that of expert witnesses. Everyone wants to know the bottom line before they go to court and the courts themselves

require expert witnesses to give genuinely balanced and independent evidence.

Partisan experts who ignore the courts' directions are a sure-fire way of losing a case. Lawyers are happiest when the quantum is suitably apportioned to the legal points at issue and forensic accountants are trained in the giving of evidence and preparation of expert reports that stand up to legal scrutiny.

The expert's report will provide background and analysis based upon all of the evidence put before them rather than areas that clients actually find favourable. Most importantly it will give the opinion of the expert in succinct terms, which should be capable of being robustly supported in court - free from commercial or contractual pressures.

Independence of expert opinion is now catching on for other forms of dispute resolution like mediation and arbitration. Showing professional impartiality simply gains credit and 'tame' experts are becoming a thing of the past.

The latest area of engagement for forensic accountants is in regulatory compliance. The Financial Services Authority will commence regulation of general insurance business on 14 January, concentrating on sales and claims. And there is good reason to expect that forensic accountants will be involved in the provision of skilled persons, reports or investigations into sales practice and claims handling, as they already assist the FSA on banking investigations, investment mis-selling and life assurance issues.

Finally, in the US, Attorney General Eliot Spitzer has just filed a lawsuit against certain brokers and insurers in respect of 'hidden' commissions.

Should the FSA decide to follow suit, forensic accountants undoubtedly have the skills to determine and extract such information - if it exists - or give a clean bill of health after a thorough audit.