An interview with Thomas W. Golden

Interview by Alistair Craven

Thomas W. Golden is the partner-in-charge of the Midwest Region Investigations & Forensic Services practice for PricewaterhouseCoopers and resides in Chicago.

He joined the firm in 1982 in the accounting and auditing practice and in 1991 he began the fraud investigations practice in the Midwest. He is a CPA and Certified Fraud Examiner whose experience has focused on providing consulting and expert witness testimony in both civil and criminal matters. He has co-authored A Guide to Forensic Accounting Investigation with PwC colleagues Steven Skalak and Mona Clayton.

In criminal matters, Mr. Golden has a national reputation in forensic accounting investigations. Many of his investigations have been conducted abroad for US-based corporations including those in Ecuador, Indonesia, Brazil, Venezuela, India and Dubai. Federal and state prosecutors have relied on his work in the development of evidence packages related to criminal investigations in the very complex area of white-collar crime.

Hello, and welcome to Management First. Can you begin by telling us about the inspiration behind your new book *A Guide to Forensic Accounting Investigation?*

Thomas W. Golden:

We at PricewaterhouseCoopers felt that there was a need for auditors, boards, management, lawyers, and everyone involved in investigations to have a trusted reference they could turn to. Forensic Accounting Investigation is a new field that has been rapidly evolving since the mid-1980s and we envisioned a book that would collect in one place all the expertise that has accumulated. We wanted to publish a comprehensive book with chapters by the best experts on each topic. No individual can know all there is to know about how to do these investigations and all the attendant risks, so we felt it was vital to publish a book based on collective experience.

Can you provide an outline of the field of forensic accounting investigation for us?

Thomas W. Golden:

There are significant differences between what auditors and forensic accounting investigators do. These differences make clear that audits and investigations are not the same. During the course of an audit, an auditor seeks to detect errors or improprieties, absent any specific information that such improprieties exist. During an investigation, a forensic accounting investigator seeks to discover the full methods and extent of improprieties that are suspected or known. Both are important features of the Fraud Deterrence Cycle, but they are, and should be, separate. They involve different procedures and they are performed by professionals with different skills, training, education, knowledge, and experience. This is an important distinction in the current environment, when some commentators have suggested that the spate of corporate scandals cries out for the conversion of the standard audit into something resembling an investigation. If the audit in the future were to take this path, the cost of performing the audit may increase.

I actually have a similar but better question: "What is forensic accounting investigation and how does what these investigators do differ from what auditors do? (this is explained in detail in chapters 1and 2 of the book).

An analogy to patrolmen and detectives can help illustrate the auditor's challenge to detect material misstatements in financial statements in contrast to a forensic accounting investigator's mission to fully investigate allegations of a specific impropriety.

A patrolman, working his particular shift, circulates through the community inspecting and observing its visible elements for signs of improper behaviour ranging from minor infractions of municipal ordinances to evidence that a major crime may have been committed. The patrolman selects his route based on past experience, the time of day and length of his

shift, and adjusts it for any particular observations during his patrol. He knows these judgments and adjustments to the patrol are necessary because no matter how much he might like to be continuously present at every location in the community, it is impossible to do so. So, too, with the auditor, who examines a selected sample of transactions to support the opinion on the financial statements and, based on those results, decides whether to examine more, whether to change the audit technique or test, or whether to conclude on the basis of procedures already completed. These decisions are based in large part on his or her assessment of the risk of material misstatement based both on past experience and current evidence. Auditors might like to go everywhere in a company and examine every transaction but, because, like the patrolman, they cannot be everyplace at every time they must determine when and where to concentrate their procedures.

The analogy of detective work is similarly revealing of the forensic accounting investigator's mission. As compared to patrol officers, who circulate throughout the community concentrating on high risk areas, detectives are not on patrol. They are called in once a crime is suspected or observed. These related but differing activities – routine patrolling and criminal investigation – can be balanced with relative ease. If greater deterrence is needed, more patrol officers covering more territory more often is a solution. Similarly, if there are many crimes or if there is a highly complex situation to investigate, then assigning more detectives, or in the financial context, more forensic accounting investigators, is a solution.

While it's clear that forensic accounting and detective work are similar, the similarities between issues confronting the auditor and the patrol officer – namely how detailed should observations be in varying circumstances – are less obvious. Take the example of a garage – the customary storage location for a reasonably valuable asset: a car. A patrol officer who drives by in the middle of the night might observe any of the following circumstances:

- Garage door closed, light off
- Garage door closed, light on
- Garage door open, light off
- Garage door open, light on, car visible
- Garage door open, light on, no car

In each case, the officer has choices, informed by knowledge of the community, past experience on patrol, knowledge of the home owner, if any, and overall security conditions in the community. If the door is closed, the light is off, and the officer drives by without stopping, few would argue neglect of duty. If the door is closed and the light on, the likely explanation is that the owner just got home and the garage door light has not gone out yet or was left on by accident. If the officer comes into the yard, looks in the garage window, sees the car and no other activity, and then leaves, almost everyone would agree that the officer has performed a careful, thorough patrol. Even if the officer drives by without looking more closely – on the assumption that the light was left on by accident – few would conclude that the officer was remiss in his or her duty. And even if a crime were silently in progress in a back room of the house, no one would fault the officer for failing to detect it from the visible evidence.

Conversely, if you were that home owner and the officer rang your doorbell, woke you from a sound sleep, told you your car was safe and sound in the garage but the garage light needed to be turned off, you'd almost certainly consider the officer overly zealous and inconsiderate, even if you agreed in principle that the light should not burn through the night.

Contrast this scenario with another. The officer spots the garage light on and the door open, comes up your driveway for a better look, sees that everything is in order, and leaves. An hour later, someone steals the entire contents of your garage. If you were to find out that the officer had been on the scene an hour beforehand and did not wake you to suggest closing the garage door, you might well be disappointed with the officer's judgment, although, truth be told, you would have been annoyed had the officer awakened you and urged you to close the door and turn off the light. Complaining loudly about the inconvenience and offering the helpful thought that there must be better things for police officers to do with their time, you would nonetheless have risen, turned off the light, and closed the door.

We all can imagine a wide range of scenarios related to patrol officers and their choices, and there will be a spectrum of views about how much investigation is appropriate. Some risk-averse residents would no doubt prefer that the officer check on whether their car is still there, even if the light is off and the door closed. Others would take the view that checking is too costly for the minimal risk evident in that circumstance. And still others would assert a right to privacy, perhaps saying that even if the light is on and the door open, stay away unless a crime is obviously in progress.

Like the patrol officer, the auditor sits outside the client company, looking in at its operations with a less-than-complete view of everything that is going on. Like the patrol officer, the auditor cannot be in all places in the company at once, cannot visit every location in each period, and

can sample transactions only at visited locations rather than examining every transaction. Further, before going out on an audit the auditor must select the timing, location, and nature of the transactions or controls to be examined – that is, make judgments about the scope of the audit work. Finally, in examining the items sampled – like the patrol officer observing the garage – the auditor has to balance risk and expectations to decide the correct scope of any further examination. If the auditor has found a potential issue, he must decide whether to expand the audit, for example by further inquiry, or decide to conclude on the basis of the available evidence that nothing improper is indicated. Choices and judgments, large and small, abound throughout the audit process.

In contrast, the forensic accounting investigators could be compared to the detectives called in to investigate a crime, like the theft of the car. The detectives will examine the scene of the crime, question everyone who might be able to shed light on the theft, and bring to bear a host of specialized forensic resources to gather any and all clues that might exist. This is a specialized, time-consuming, and costly mission not directly connected with the original mission of patrolling the community to ascertain that everything is substantially in order. After all of their effort, the detectives may find out only that your child – a newly licensed teenage driver – decided to take the car down by the river to practice guitar without disturbing you. On the other hand, they may uncover a car theft ring. It might make sense to call upon the detectives more frequently, but consideration must be given to the ratio of detectives to police officers (there just are not as many) and to the cost of detectives, which is typically higher than that of patrol officers. Judgements are made that balance the community's desire for safety with the cost it is willing to pay for such comfort.

Many corporate criminologists agree that corporate crime and violence inflicts far more damage on society than all street crime combined. What is your take on this?

Thomas W. Golden:

Enron really brought this home to many. Ordinary people who worked for a company 30 some years not only lost their jobs and their careers, but their entire life savings, their pensions, and finally their self-respect. If anyone calls that crime "victimless" they have no heart.

More damage? There is really no way to measure this. It's like asking would you rather lose a foot or an arm? Be deaf or blind? Be poor or illiterate? All crime is bad.

In response to the spate of corporate financial scandals, in 2002 US congress passed the Sarbanes-Oxley Act in an attempt to protect investors. Has this Act been successful in what it set out to achieve?

Thomas W. Golden:

There are many things we don't know about effectively answering this question, but a few things we do know.

The new Cox commission is taking a fresh look at the whole idea of rational market regulation and I am certain they will do so in an effective manner. I am also confident that this process will result in fostering a body of regulation which considers the cost of regulation against the benefits to the investor. This is as it should be.

Sarbanes-Oxley (S-O) has gone a long way toward resetting the corporate compass with regard to business ethics and this is a good thing. Employees are more apt to report suspected wrongdoing and participate in remedial actions where they find deficiencies. Putting three whistleblowers on the cover of Time Magazine has a way of legitimizing such behaviour. This is good as well.

But there has been a downside to S-O. I believe it has caused many to become overconfident. Companies have spent millions of dollars and much in terms of human resources and board attention toward improving their control systems, which is what S-O is all about, not fraud. Many forget this. As such, many now believe they have plugged the dyke, so to speak, and now believe that fraud is less likely to occur for all their dollars and efforts. They are wrong.

What they many not realize or are forgetting is that controls have little to no effect against collusion, present in most all significant F/S frauds. You may have great controls in cash and accounts payable including segregation of duty, but if those two employees get together in the parking lot and decide to rip off the company, there is little about S-O that will stop them. And remember that the SEC reported that over 70 per cent of all material financial statement fraud involved an officer of the company. When executive management gets involved in the fraud, there is little that your control system can do to prevent it or detect it on a timely basis.

So, S-O was, on balance, needed and good for the capital markets and has gone some reasonable distance in restoring investor confidence. But we should never forget that as long as there are people who have needs and opportunities to do something wrong – and have

the wherewithal to rationalize their actions thereby having no trouble sleeping at night – there will be many more catastrophic frauds. This is a virtual certainly.

Worryingly, nearly half of all companies experience significant fraud, yet even more worryingly, many organizations will not have a systemic plan in place for deterring and investigating corporate fraud. Why is this so?

Thomas W. Golden:

Because fraud is something that happens to other companies. Many believe that if they hire honest people, have annual audits and comply with S-O, they are insulated from significant fraud. They are wrong.

Our 2005 Global Economic Crime Survey (GECS) revealed that unless people had experienced significant fraud, most of them truly do not believe they will become a victim of fraud. I believe this is partly related to overconfidence as a result of S-O, and partly human nature. Most believe that bad things will happen to other people, not to them. Our survey revealed that for those not reporting significant fraud, 90 per cent did not believe they would become a victim of fraud in the next five years. However, for those companies reporting significant fraud in the last two years, that number was reduced to 67 per cent.

If more people operating in their control environments would follow a simply practice of "trust but verify", more fraud would be deterred or detected. The phrase – borrowed from Ronald Reagan in his negotiations with the Soviets over the missile defence treaty during the mid-1980s – acknowledges that trust is only a valid concept if supported by verification. Applied to the internal control environment of our corporations, it requires that people never assess the accuracy, validity and completeness of any transaction by the presumed character of the person who has either created or approved the transaction. I will verify... then trust.

Leading on from this, what are the financial benefits of effective fraud management?

Thomas W. Golden:

Effective fraud management will deter fraud. The effects of fraud can go far beyond the financial loss from just the fraud. There can be a loss of brand loyalty with consumers, loss of vendor support and far reaching negative publicity having downward pressure on the company's stock and market stature for many years to come.

Additionally, employee loyalty strengthens companies. The stronger the employees attach themselves to the company's brand, the less likely they are to defraud it, our GECS found.

You state in your book that knowing where to look for fraud is a key component in detecting it. In investigating this further, you include a chapter on the "psychology of the fraudster." Aside from the obvious motive of greed, what other reasons are there behind acts of corporate fraud?

Thomas W. Golden:

We are a nation of winners. No one likes to lose. Not in the long run, anyway. We all have needs. For most of us it's the need for recognition and reward, but for many it could simply be the need for acceptance – to be liked and admired. I've seen big frauds perpetrated by individuals who had no extrinsic personal gain. I have a matter now where a CFO aided and abetted a vendor by certifying payables to the vendor (his receivables) to the vendor's factor who in turn, loaned funds on bogus receivables. It eventually collapsed. The CFO received only the friendship of the vendor who came to town on a periodic basis and took him out to dinner and a ball game. Now the CFO stands to go to prison for up to 15 years – a stiff price to pay for companionship.

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In another example, the CFO of a hospital falsified the books and records to artificially inflate earnings just for the pleasure of seeing his

counterparts in other hospitals within the same group envy his success. Any bonuses he received were negligible.

What is the relationship between good corporate governance and fraud detection?

Thomas W. Golden:

We live in the post-Enron era. The keynotes of the era are tough new legislation and regulation to strengthen corporate governance and new oversight of the auditors. A significant part of corporate governance is the design, implementation and maintenance of an adequate system of internal controls – what S-O is all about.

Corporate governance is about fraud deterrence, not prevention and not detection. It can be likened to the rule of law and having the will, power and ability to enforce such laws. Governance can not be realized on a long-term basis without having enforcement powers. To deter would-be fraudsters, they need to realize that the likelihood of getting caught and punished is high enough that the risk is not worth it. Liken it to a taxing authority. Paying 30-45 per cent of our income to taxing authorities is a significant burden to most and there are temptations not to pay such taxing authorities unless strict enforcement was a virtual certainty in the event of non-compliance. Without the belief that punishment would be certain, swift and punitive, a government could not enforce the rule of law.

Without the ability to detect fraud, there can be no enforcement and without enforcement, there can be no effective governance.

An article in our journal *Cross Cultural Management* examines the impact that culture has on ethical dilemmas. According to the author, it seems intuitive that people will interpret fraud based on what they believe constitutes fraud, and whilst this is not a new idea, it does pose an intriguing quandary: what constitutes a corrupt act in one culture may be considered a legitimate, or at least a quasi-legitimate business or social practice in another. What is your take on this?

Thomas W. Golden:

Culture is too often used as an excuse for crime.

In my home state of Illinois, the long-awaited jury verdict recently came down in the trial of our former governor. "Guilty on all counts", read the forewoman, and Governor George Ryan remarked, "This decision today is not in accordance with the kind of public service that I've provided to the people of Illinois over 40 years." He reasoned that the culture of politics in Illinois absolutely fosters this kind of behaviour. He reasons that he was just doing what his predecessors have done for years.

Ryan did what most white collar criminals have done for years. They have completely rationalized their misdeeds and corruption as perfectly legitimate behaviour. They rationalize that they have given to the citizens (or the company) and so if they take a little for themselves, why that's perfectly justified. Go right down the list and you will find the same behaviour: Martha Stewart, Dennis Kozlowski, and Bernie Ebbers. It will be a rare day indeed when you find one of these celebrity crooks, or even the not-so-famous everyday crook, actually take responsibility for what they have done unless it's part of their plea agreement. So why is this?

It's really quite simple. Most white collar criminals do not intend to cause harm. Most believe that if they are basically a "good person" then there is some rational basis for the illegal or inappropriate activity they are charged with committing. Rationalization is what allows these criminals to do the dirty deed and then sleep like babies. Because in their own minds, they didn't do anything wrong – even after a jury has seen it otherwise.

Consider your own behaviour. I bet you've rationalized before. No? You never break the speed limit? Oh. But then you were in a hurry. You only do it when it's absolutely necessary. And the act of speeding actually makes you more attentive and therefore a better driver. And the best of all: it's really not breaking "the law", after all, it's just a traffic ordinance, right? People who steal millions and falsify financial statements justify there actions in much the same way.

There has been much focus of late on the importance of whistle-blowing. However, in the *Journal of Financial Crime*, Henry H. Rossbacher has suggested that there is no evidence to suggest that whistle-blowing has contributed significantly to the "exposure of the wrongdoing now filling the headlines and emptying shareholders' accounts." Do you agree with his statement?

Thomas W. Golden:

He's wrong.

Seemingly objective evidence can sometimes lead us into making bad decisions. For example, Michael Jackson was found innocent of the

charges filed against him. I still would not take my grandkids over to his house to play.

Whistle-blowing is not without its detractions, that is for sure. But make no mistake about it, the fact that the S-O Act included a provision requiring some mechanism for surfacing possible inappropriate activity has provided for, in my view, the best control to prevent corporate fraud. Those who would contemplate wrongdoing will have to think twice if the company has set up a whistleblower hot line such that employees can report on suspicious activity from the comfort of their own homes, 24/7. You see, this mechanism puts forth the perception in companies that if you do something wrong you will be caught which is the best fraud deterrent mechanism out there.

S-O has removed the stigma of "ratting" on your boss, which used to be unheard of. You just didn't rat on anyone. Well, things have changed. Heck, it's almost patriotic to be a whistleblower.

The major detraction is that whistleblower hot lines may provide a mechanism for some disgruntled employees to lash out against their bosses for unsubstantiated reasons. They may also be reporting what they truly believe is suspicious activity when in fact they are not aware that the issue they have identified is already known by the company and handled at another level of the corporation. For example, the whistleblower may see certain journal entries being made at the division without support, but then supported, or adjusted or reversed in consolidation. That may create more work and sometimes headache for the company, but in my view, it's an acceptable trade-off.

Roger Davis, retired Head of Professional Affairs at PwC, has asked the question as to whether there is a danger of increased corporate regulation around the world becoming a dead hand on entrepreneurship and innovation. How would you answer his concerns?

Thomas W. Golden:

While I do believe in allowing markets to operate freely, some degree of regulation is necessary in a number of circumstances, and ensuring fair dealings in the capital markets is certainly one of those areas. The 1933 Securities Act and the Securities and Exchange Act of 1934 are testament to this argument. Where would we be had these two laws not been passed? Clearly, we'd have no capital markets, at least not in the United States.

The whole issue of rational regulation is currently under review by the SEC. Other countries and Unions are exploring S-O type laws. Yes, there is a risk that regulation may stifle entrepreneurship, but the costs of failing in this effort – that of achieving the right balance between regulation and restoring investor confidence – are too great not to address in the exact manner that governments are doing.

Innovation, like nature, I believe will always find a way. I don't think that S-O would have stopped Tom Edison, Andy Grove of Intel or Sergey Brin, founder of Google. If it's an issue of risk to innovation, I'd be more concerned that we get immigration law reform right. □