



Financial investigation to uncover Hong Kong securities dealing fraud

KW Chong looks at a recent investigation undertaken by our Hong Kong office.

The activities resulting in securities dealing fraud usually carry with them serious implications for both the duped investor and the individual(s) responsible for the fraud.

When the fraud is uncovered the investor will scurry to recoup its remaining investment, whilst the perpetrator of the fraud will be inclined to hide or dispose of evidence implicating him/her in the matter. In this situation it is imperative to act quickly to investigate the matter, but with a balanced and impartial approach. The Forensic Accountant is an ideal, independent and skilled party to undertake the investigation role.

Ferrier Hodgson in Hong Kong was recently engaged to investigate allegations of securities dealing fraud, to document evidence of such activities and to conduct a review of the internal controls of a brokerage firm. In this matter the misuse of client accounts by a dealing director was discovered when management of a brokerage firm identified several client accounts with significant unsettled amounts. It was later determined that the unsettled amounts had arisen when the volatile market moved against the unauthorised transactions, leaving the unmanageable situation where profits generated from trading were not sufficient to cover the trading losses realised.

The initial approach taken by Ferrier Hodgson was to conduct the positive circularisation of clients of the brokerage firm as well as other analyses in order to quickly establish:

1 Extent of the use of client accounts

- FH traced the movements in the clients' stock and cash balances over the period considered relevant to the investigation.
- FH reviewed and compared transactions between the supporting documents provided by clients and the company's records on a transaction by transaction basis. In so doing, we were able to match bought and sold transactions and verify if discrepancies found were due to the unauthorised transactions.

2 Potential loss to the brokerage firm

- The comparison on a transaction by transaction basis allowed the quantification of the overall loss incurred by the brokerage firm (on a gross basis) but also helped to identify profitable unauthorised transactions.

3 Improper settlement procedures

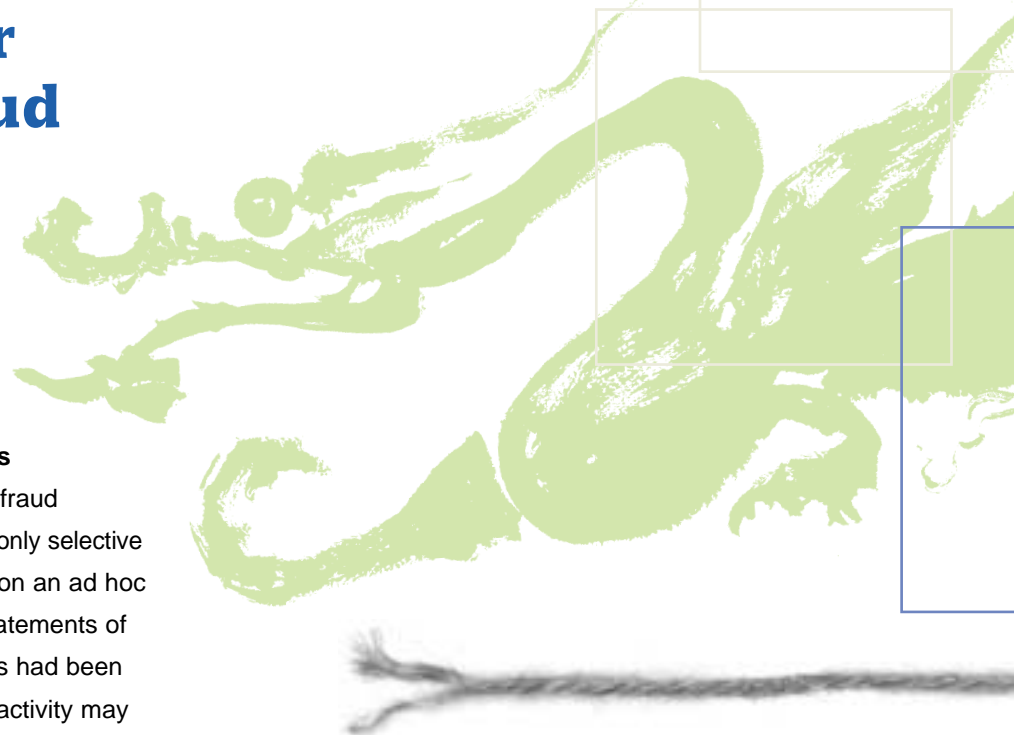
- Clients who were affected by the fraud indicated that they either received only selective statements of trading activity (ie. on an ad hoc basis) or that they received no statements of trading activity at all. If statements had been independently sent to clients the activity may have been uncovered earlier.
- Further, most client contact notes, statements of account, payments and cheques issued to the affected clients were issued via the dealing director. Unfortunately these were withheld.
- Unpresented cheques that were withheld were used to settle subsequent unauthorised purchase transactions without the clients' knowledge.

From the evidence gathered by Ferrier Hodgson in this forensic exercise it was shown that, despite several controls being in place, the dealing director was able to abuse his power and side-step the system. We were able to provide an independent assessment of the shortcomings of controls and the circumstances which gave rise to the misappropriation of client funds, the use of client accounts, the extent and quantification of the unauthorised transactions.

Ferrier Hodgson also made recommendations for management to consider in implementing improved internal controls, as well as assisting the claim under the broker's fidelity insurance policy.

It is therefore imperative (even in cases where internal controls have been put in place) that effective, regular and independent checks are carried out to ensure strict compliance to policies and procedures throughout all levels of authority in the business. We suggest that when fraudulent activity is suspected management engage the services of an independent Forensic Accountant to quickly and effectively assist in the matter.

KW Chong is a Senior Manager with the Hong Kong office of Ferrier Hodgson working in Forensic Accounting, Litigation Support and Corporate Recovery and Reconstruction.



In this issue:

- Uncovering a Hong Kong Securities Dealing Fraud
- Internet Trivia
- Partner profile: Greg Meredith
- Cause of loss and damage... a forensic burden

- Litigation Support
- Fraud Investigations
- Financial Investigations
- Computer Forensics



Partner profile: Greg Meredith

Greg Meredith joined Ferrier Hodgson in 1989 and became a Partner in Melbourne in July 1994.

He has conducted a large number of investigating accountant and consulting assignments for banks and companies across a broad spectrum of industries including engineering, mining, property, media, meat processing, food distribution, manufacturing and professional services.

Greg has prepared reports as an independent expert in numerous legal proceedings, including:

- Valuation and assessment of damages emanating out of misrepresentations on the purchase of a business.
- Opinions on company solvency.
- Loss of profits emanating from contractual breaches.

- Loss and damage calculations for Trade Practices Act claims.
- Critique of expert witness statements and valuations for trial purposes.
- Investigation report in respect of a taxation fraud.
- Analysis of complex trust arrangements for valuation purposes in family / legal disputes.

He has acted as a Court appointed special referee for the Supreme Court in a complex franchising dispute. Greg has also conducted a number of complex financial investigations for clients including the Victorian Government.

Greg has an interest in information technology applications for business and is responsible for Ferrier Hodgson's (Victoria) IT strategy.



Cause of loss and damage... a forensic burden

The traditional role of the Forensic Accountant has, inter alia, been associated with matters of determining the quantum of loss. Peter Holmes, Partner of our Adelaide office argues that the forensic examination of the cause(s) of losses is to be taken in a new light, in view of the recent High Court decision in I&L Securities.

The case concerned the issue of whether discretionary powers under s.87 of the Trade Practices Act ('the Act') empowered a Court to award judgment for less than the amount of the loss suffered as a result of any contravening conduct. In relation to s.87, the Court found it did not enable any such reduction.

Whilst Kirby J wrote a dissenting judgment, his Honour commented that: "whilst a party such as the appellant bore the ultimate burden of demonstrating what loss or damage had been sustained, once a contravention was shown, a forensic burden at least was borne by a party (such as itself) to demonstrate that some other, independent, cause of loss or damage existed".

The task of the Court in deciding a claim for recovery of loss and damage is: "to ascertain the loss suffered by the contravening conduct and to assess the amount necessary to compensate for that loss. Once it is accepted, it follows, in my view, that considerations of foreseeability and contributory negligence are irrelevant... However, that does not mean that, where the loss is the result of two or more acts or events, causation is irrelevant to the task of identifying the loss or the amount of the loss recoverable. To treat causation as irrelevant would be to ignore the requirement in s.82(1) that a person suffer loss or injury by contravening conduct."

The quantification of losses that have been incurred after any contravening conduct is generally not (forensically) difficult to ascertain, but does require an assessment of the facts and circumstances surrounding those losses.

For example, dissection of divisional or business results from consolidated financial results may be required.

However, in the light of the Henville v Walker and I&L Securities decisions, it is questionable whether all of a loss can be attributed to a contravening conduct. A thorough search of facts and circumstances surrounding the 'event' itself may reveal factors that have created other losses after the event.

As commented by Gleeson CJ: "the possible existence, in different circumstances, of those and other complications directs attention to the kinds of problems inherent in the word 'by' in s.82"

"Here, we are concerned, not with common law principles (of contract or tort), but with statutory rights and liabilities. However, the same problems arise, and must be dealt with in conformity with the statute."

It is perhaps disconcerting or inequitable that: "it follows from the decision in Henville v Walker that there is nothing in s.82(1), in other provisions of the Act, or in the policy of the Act, to suggest that a claimant's carelessness may be taken into account to reduce the amount of the loss or damage which the claimant is entitled to recover under s.82(1)."

Nevertheless, it appears still open that a Court may find that losses can be divided into parts, and a forensic burden falls on the respondent to identify those parts. Forensic accountants may therefore prove to be a useful tool in examining the commercial and financial conduct of applicants, in order to establish whether other causes of loss can be argued, not to reduce the damages, but to divide and identify losses attributable to respondents. That is, to determine the 'loss caused by'.

Peter Holmes is a Partner of Forensic Accounting, based in Adelaide. For over 12 years Peter has been involved in numerous matters including financial investigations, fraud investigations, professional negligence, assessment of loss, valuations, proof of insolvency, and giving expert evidence in numerous Courts. In addition, he consults to the Law Society of South Australia, and has lectured to the legal profession in South Australia and the Northern Territory.

About forensics@ferriers...

forensics@ferriers is a newsletter issued by Ferrier Hodgson discussing current issues in the area of Forensic Accounting – litigation support, fraud investigations, financial investigations and computer forensics. For comments please contact john.temple-cole@syd.fh.com.au Alternatively you can read forensics@ferriers on our website.

Australia Please note – the material contained in this newsletter is merely general commentary. The facts of each particular situation vary as does legislative and judicial interpretation of any law commented upon. The comments and information herein do not constitute and must not be relied on as legal or professional advice. Advice tailored to your specific situation should be sought from any Ferrier Hodgson affiliated office before acting in any of these areas.

Ferrier Hodgson is committed to respecting the privacy of your personal information. We are bound by the Privacy Act 1988 and the National Privacy Principles, which set out a number of principles concerning the collection, storage, use and disclosure of personal information. You have the right to access and request correction of your personal information that we hold. We may use your personal information for our own advertising and marketing purposes. If you wish to contact us concerning any issues relating to privacy, to obtain a copy of our privacy policy, or if you wish to be removed from our database and do not wish to receive future mail outs, please email us at privacyofficer@syd.fh.com.au or telephone Mr Robert Fitt on (02) 9286 9999.

Hong Kong If your details have changed or you would like to subscribe or unsubscribe to this publication, please contact kkam@fh.com.hk

Internet trivia

Jason Beckett unravels some common Internet myths.

Why was the Internet built?

Many people believe the Internet was built so communications were still possible after a nuclear war, but in fact the original reason for funding the ARPANET (Advanced Research Projects Agency) was to find a way of enabling expensive but incompatible mainframe computers to communicate so that they could become shared resources for the researchers funded by the Advanced Research Projects Agency of the US Department of Defence.

How old is the Internet?

The modern Internet dates back to 1983, but was largely based on the ARPANET, which passed its first message along on 1st October, 1969.

How old is the World Wide Web?

It was invented in 1989 at CERN (European Organisation for Nuclear Research) by the English software engineer, Tim Berners-Lee.

How many people are on the Internet?

There are many statistics and they change by the minute, but in September, 2002 there were an estimated 605.4 Million users.

Where does the word 'Cyberspace' come from?

The novel, *Neuromancer*, published in 1984 by the American writer William Gibson. He described it as a 'consensual illusion'.

Jason Beckett is Senior Manager of Computer Forensics in Sydney, specialising in the preservation and examination of electronic and internet evidence.

For more information about our Forensic Accounting Services please contact:

Sydney: Michael Potter
Phone: (02) 9286-9999
michael.potter@syd.fh.com.au

Melbourne: Greg Meredith
Phone: (03) 9600 4922
gmeredith@melb.fh.com.au

Adelaide: Peter Holmes
Phone: (08) 8235 7655
pholmes@sa.fh.com.au

Perth: Garry Trevor
Phone (08) 9221 2460
gtrevor@perth.fh.com.au

Hong Kong: John Lees
Phone: + (852) 2820 5600
jrlees@fh.com.hk

Or find out more about Forensic Accounting at:
www.ferrierhodgson.com



FERRIER HODGSON
FORENSIC ACCOUNTING DIVISION