Using Computers to Catch Corporate Fraud

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By Daniel Sorid

NEW YORK (Reuters) - Accounting software makers are trying to capitalize on a string of high profile scandals by developing computer programs that flag unusual bookkeeping and launch investigations with little human intervention.

For company officials, reviewing reams of corporate data can be a daunting -- and occasionally mind-numbing -- task.

Where an accountant's eyes might glaze over with fatigue, computer software can conduct endless checks and analysis to identify sources of possible fraud.

And companies have a powerful, new incentive to catch books that are cooked: new laws make executives personally liable if fraud is discovered.

To reduce their own risks, large companies are turning to software from Hyperion Solutions Corp. HYSL.O , which has more than 6,000 customers. Hyperion's tools roll up general ledger entries into consolidated financial reports, and also allow complex budgeting, planning, and forecasting.

Hyperion executives said the company plans to develop tools that can combine basic analysis with so-called rule processing, allowing executives to drill down into the books and automatically launch investigations when unusual entries cannot be explained away by such factors as staff level changes.

"Companies want to have a lot more of the analysis done before the earnings release," Jeff Rodek, Hyperion's chairman and chief executive, said. "If you're doing a bit of detective work, the trail would be hotter the sooner that you spot a variance."

One example Hyperion gives is WorldCom Inc. WCOEQ.PK . The company's capital spending "was higher than anybody else's in the industry," said the company's Chief Development Officer Robert Gersten. An appropriate package of software could have flagged the anomaly to company executives and auditors.

Wall Street is keen on Hyperion's future. The company's stock is up 30 percent this year, a feat for a software company in a bear market. Mark Murphy, a software analyst at First Albany Corp., said he expects Hyperion's revenue to increase in its current fiscal year.

"You're going to want more of a way to show that whatever we did, whatever we've reported, whatever we used to base our forecasts off of, we weren't making it up," Murphy said.

Hyperion shares were off 16 cents and $28.18 on NASDAQ in late afternoon trading on Friday.

WHEN HUMAN EYES FAIL

Classic signs of impropriety can be identified faster and more regularly with the help of technology, said Toby Bishop, who runs the Association of Certified Fraud Examiners, a professional organization with 26,000 members.

Identifying patterns is a key strength of a computer. Software, Bishop said, can easily spot patterns that show a company regularly relying on last-minute sales to meet Wall Street earnings estimates -- often a sign of desperation to satisfy investor demands.

A software tool could also compare a company's provision for bad debt with competitors and the industry as a whole, Bishop said. Companies sometimes boost earnings just by low-balling their estimate of how many customers will not be able to pay for orders.

Software can also dig into the practice of so-called multiple closings. Company accountants sometimes finalize quarterly results with a series of final tweaks, supposedly to iron out any wrinkles in the numbers. Adding a few cents a share during the process -- by modifying a number here and there -- can be spotted by software designed to investigate such a technique.

Nothing would stop a team of accountants with a pencil and a spreadsheet from completing such analysis. But a computer can scan vast amounts of historical data quickly, and can make graphs and charts that show patterns far more clearly than spreadsheets, Bishop said.

WANTED: GOOD SOFTWARE AND HONEST EXECS TO USE IT

The amount of available software used to ferret out corporate malfeasance has exploded since the recent horror shows at Enron Corp. ENRNQ.PK , WorldCom, and Tyco International Inc. TYC.N .

But the software can only do so much, and ill-intentioned corporate officers can make even the most sophisticated technology moot.

FRX, an accounting software company for small and medium-sized businesses owned by Microsoft Corp. MSFT.O , builds software that allows companies to identify anomalies between budgets and actual results, and allow executives to peruse individual transactions that may be the culprit.

Software has also been used successfully by credit card and insurance companies to catch fraudulent transactions. But skeptics say no technology can catch a corrupt CFO, or identify sham deals in a firm that hasn't implemented basic safeguards.

Moreover, these software tools are only useful for company insiders. Stock analysts and investors who bet against a company's stock would not find any value in software that needs access to a company's private books to be useful.

"We've seen a real risk of people being seduced by technology," Bishop said. Bishop's association has published a fraud prevention check-up for companies -- urging measures as basic as naming an executive to identify fraud risks. Fraud prevention, as opposed to detection, is 80 percent of the work.

Still, companies remain "woefully underprepared to fight fraud and are really sitting ducks for any outsider or member of management who one day decides to take advantage of them," Bishop said.

Even the software companies admit the limitations of technology.

"Technology is not a solution to an ethical problem," FRX Director of Marketing Andy Kamlet said. "There are certain things you just can't prevent."
