Introduction

The Live Entertainment Corporation of Canada Inc. (“Livent”) was a company that most North Americans relied on to experience contemporary arts and issues in theater form. However, this all came to a close in 1998 when the Royal Canadian Mounted Police (RCMP) and securities regulators in the United States (U.S.) and Canada began a criminal investigation into the Company’s financial records. As we are approaching the 15th anniversary of the now infamous Livent Fraud, it is an opportune time to revisit what some have classified to be the “worst case of financial statement fraud” in Canada’s history (Brennan and Mary McGrath, 2010: 55). The Livent fraud bilked investors of “approximately $500 million dollars”; a crime that saw the Company’s owners, Garth Drabinsky (“Drabinsky”) and Myron Gottlieb (“Gottlieb”), being found guilty and convicted on “fraud and forgery charges” (Canadian Broadcasting Corporation, 2009: para. 1 & 3).

The purpose of this paper is to examine the risk factors that led to the Livent fraud, and the procedures that need to be taken by responsible third parties to carefully investigate and address the incidents of misconduct. To do this, I proceed in four steps. First, I will briefly recount the sequence of events that led to the exposure of the Livent fraud. Next, I will describe the process that led to the discovery of the fraud. Given the manner in which the fraud was discovered, I will then comb through the steps that a forensic accountant should have taken to determine whether an incident had in fact occurred, who the responsible parties were, and the nature and extent of the losses that resulted from the fraud. Finally, I will highlight the lessons learned and their possible applications for effective fraud control in corporate environments.

1. Recounting the sequence of events involved

a. Livent: A Chronology of Events

The sequence of events that led to the Livent fraud covered a period of fourteen years (See Heaven, 2009a). As the story goes, in 1989, Drabinsky and Gottlieb (co-founders of Livent) were both forced out of the Cineplex Odeon Corporation. In turn, “they took the consolation prize of the Pantages theatre and rights to a stage production of The Phantom of the Opera” (para. 1). In 1990, Livent was founded by Drabinsky and Gottlieb (para. 2). In 1993, Livent went public with an initial public offering (IPO) (see Shannon, 2009). In 1995, “Alex Winch, a Toronto investment analyst, writes a letter to Forbes magazine suggesting Livent's accounting is not as conservative as executives say it is”, and notes that “sophisticated accounting methods are being employed to postpone the impact of the high cost of the company's productions” (Heaven, 2009: para. 4). In 1996, “Livent sues Mr. Winch for $10-million. He settled out of court and agreed to a gag order that prohibited him from discussing Livent” (para. 5).

In 1998, the early signs of problems started to present themselves at Livent. In April of 1998, “Livent [took] a US$27-million write-down on its investment in [the musical] Show Boat”; and it was also around this time that “[f]ormer Hollywood agent Michael Ovitz (“Ovitz”) made a deal to invest US$20-million in Livent” (para. 8). Drabinsky and Gottlieb voluntary “step[ped]
aside”, and handed “over control to the new investors led by … Ovitz (para. 8).” In August of 1998, irregularities were found in Livent’s books, which led to the ousting of Drabinsky and Gottlieb (para. 9). After Drabinsky and Gottlieb were expelled, the world renowned accounting firm, Klynveld Peat Marwick Goerdeler (KPMG), “was hired to do a forensic audit into suspected financial irregularities in the company's books” (para. 9). In “October of 1998, Regulators in Canada and the United States launch[ed] probes into claims [that] Livent improbably overstated its financial results” (Shannon, 2009: para.1). In “November, 1998 Livent file[d] a $225-million lawsuit against the company founders Drabinsky and Gottlieb over allegations [that] they inflated the theatre company's financial results and took kickbacks” (para. 2). More specifically, “Mr. Ovitz, file[d] a civil lawsuit against Drabinsky and Gottlieb, alleging they overstated earnings, assets and hid losses … Mr. Drabinsky counter-sue[d], claiming a "conspiracy scheme" to oust him” (Heaven, 2009a: para. 10).

b. The Charges

Beginning in 1999, a series of charges were laid against Drabinsky and Gottlieb in both Canada and the United States (U.S.). In January of 1999, both the U.S. Department of Justice and the Securities and Exchange Commission (SEC), filed criminal and civil charges against Drabinsky and Gottlieb. More specifically, a “U.S. federal grand jury” indicted both Drabinsky and Gottlieb “on 16 counts of securities fraud and conspiracy in New York, where they face up to 140 years in prison and fines of up to US$16 million if convicted” (Kingston, 2009: para.2). The SEC “also announced civil charges against nine former senior officials, including the Livent co-founders. The SEC accused the nine of "engaging in a multifaceted and pervasive fraud spanning eight years from 1990 to 1998" (Clark, 1999: para.4). In October of 2002, the Royal Canadian Mounted Police (RCMP) laid charges against Drabinsky and Gottlieb including “19 criminal counts” that was “later reduced to three” for defrauding investors and falsifying financial statements (Heaven, 2009a: para. 12). In “July, 2007, an Ontario court order[ed] Drabinsky and Gottlieb to pay US$36.6-million to U.S. investors who bought Livent's debt in the late 1990s (Heavens, 2009b: para. 16).” Finally, on “March 25, 2009 Drabinsky and Gottlieb were convicted of two counts of fraud and one count of uttering forged documents in a verdict issued by Ontario Superior Court Justice, Mary Benotto” (para. 14). They were sentenced to five years in prison and released on pay parole in 2012.

2. Discovery of the fraud

The Livent scandal began to surface in 1998. Drabinsky, noted for being “flamboyant”, was also a “perfectionist” by nature (Knaap, 2008: 389). Given Drabinsky’s penchant for being a stickler and flamboyant, he “demanded that the company’s live productions be ‘motion-picture perfect’”, which resulted in “most of Livent’s shows, particularly those that were box-office successes, incur[ring] huge cost overruns” (p. 389). In April of 1998, Livent was under severe debt that was incurred by Drabinsky, “to finance the company’s lavish production (p. 390).” Roy Furman
(“Furman”), a New York investment banker and “close friend” of Drabinsky’s, persuaded him “to accept a $20 million dollar investment from former Disney executive Ovitz, to alleviate Livent’s financial problems” (p. 390). Part of Ovitz’s deal in this investment, was that he be “granted sufficient common stock voting rights to allow him to control the company’s board of directors” (p. 390).

a. The Forensic Audit

Before agreeing to invest in Livent, Ovitz hired KPMG to do a due diligence screening of the company's books; but, KPMG did not find any discrepancies in their examination (Petersen, 1998: 2). Ovitz then, “became the company’s largest stockholder in early June of 1998[,] and took over effective control of the company” (Knaap, 2008: 390). Soon after Ovitz took over, he earnestly began to restructure the board and created a new management team at Livent. Ovitz himself became the “chairman of the board’s executive committee”; “Furman assumed Drabinsky’s former titles of chairman of the board and CEO”; Drabinsky became “vice-chairman and chief creative director”, where he was to “oversee the all-important creative facets of Livent’s operations”; Quincy Jones (“Jones”) was also appointed on the board to provide “a second opinion on artistic matters”; Gottlieb was demoted “to a vice-president position”; KPMG audit partner Robert Webster (“Webster”), who earlier had supervised KPMG’s due diligence investigation of Livent’s accounting records, was appointed “to serve as an executive vice-president of the company” and “was given a broad range of responsibilities[,] but[,] his principal role was apparently to monitor Livent’s accounting and finance functions for Ovitz’s new management team” (p. 390).

Immediately after the new management committee was formed, Webster went to work. He wanted to examine the books for the new owners, but soon discovered that the accounting staff at Livent was “reluctant” to cooperate with his requests (Petersen, 1998: 8). Upon further investigation, Webster noted that “he became ‘greatly concerned’ when some of the accountants told him that Mr. Drabinsky had warned them not to provide certain financial information until the producer had reviewed and approved it” (para. 8). In August of 1998, Maria Messina (“Messina”), Chief Financial Officer at the time, decided to tell Webster the full story when she was asked “to prepare a report on construction costs for a Chicago theatre” (Small, 2008: para.2). Messina then met with “Tony Fiorino (“Fiorino”), Livent's construction costs controller, and they agreed to prepare a schedule revealing that millions of dollars in expenses had been improperly reported as assets” (para. 11). Messina testified in court that Webster, “was quite shocked, quite taken aback”, and even “asked if there was any more that he need[ed] to know” (para. 12 & 13). Messina answered “there was,” and went on to assemble five other accounting staff members at Livent to assist her in preparing a report, “to disclose the full fraud to Webster” (para. 14 & 15). Webster noted that the information provided by the accountants at Livent, “cast[ed] doubt upon the veracity and accuracy" of the company’s financial records (Petersen, 1998: 9). The records indicated that Livent was involved in backyard accounting and cooked its books for years (See Loomis, 1999). The accountants revealed “to Webster that Livent’s accounting records had been distorted by a series of fraudulent schemes initiated and coordinated by Drabinsky and other top Livent executives” (Knaap, 2008: 391). Webster then relayed the information to the Livent board and in August of 1998, “Furman issued a press release announcing that ‘significant financial irregularities’ adversely affecting Livent’s financial
b. What did the Forensic Audit Found?

So, what were these, “massive, systematic, accounting irregularities” that KPMG was referring to? The following is a brief breakdown of the fraud that Livent’s management committee and accountants were involved in. It is not my intention, formidable as it is, to provide an extensive review of the fraud, but rather to highlight the key facts and acts that led to Livent being such a massive scandal in both Canada and the U.S. (Knaap, 2008: 391).ii

Livent's multifaceted fraud began with a kickback scheme orchestrated by Drabinsky and Gottlieb in the 1990’s. According to the SEC, “as early as 1990 and continuing through 1994, Drabinsky and Gottlieb operated a kickback scheme with two Livent vendors designed to siphon millions of dollars from the company directly into their own pockets” (SEC, 1999a: para. 12). The SEC noted that,

Drabinsky and Gottlieb orchestrated the kickback fraud by enlisting Peter Kofman ("Kofman"), a Canadian engineer, and Roy Wayment ("Wayment"), owner of a Canadian construction company, to artificially inflate invoices. Gottlieb specified to the vendors the bogus descriptions of the services rendered for insertion in the invoices, as well as the dollar amounts which greatly exceeded the costs of services actually performed. Livent then paid the invoices, through cheques signed by Drabinsky or Gottlieb, and the vendors returned most of the money directly to Drabinsky and Gottlieb, or to Gottlieb's Canadian company, King Commodity Services Limited ("King Commodity") (para. 13).

It is estimated that between 1990 and 1994, the time interval of the kickbacks, Drabinsky and Gottlieb received about $7 million from Kofman and Wayment (para. 14). It is alleged that,

the fake charges billed to Livent by the vendors were capitalized in “preproduction” cost accounts for the various shows being developed by the company. Legitimate costs charged to those accounts included expenditures to produce sets and costumes for new shows, costs that were amortized over a maximum period of five years (Knaap, 2008: 392).

The kickback scheme led to huge losses from Livent coffers and made it difficult for the company to meet its quarterly target, satisfy creditors’ obligations, maximize shareholders’ wealth, and “meet the earnings and operating projections they provided to Wall Street analysts” (SEC, 1999a: para. 17). Realizing that the company was now in dire need of money to meet its earnings targets, “Drabinsky and Gottlieb directed Livent’s accounting staff to engage in an array of ‘accounting manipulations’ to obscure the company’s financial problems” (Knaap, 2008: 392). The accounting methods employed by Livent to manipulate the income reported falls into four categories. They are as follows:
transfers to fixed assets: allocating operating and preproduction costs to fixed assets accounts related to theatres and buildings under construction;

expense rolls: arbitrarily moving operating expenses from one period to another;

amortization rolls: failing to subtract expenses that were supposed to be amortized by moving them to other periods; and


To carry out these manipulations, Livent first,

transferred preproduction costs for shows to fixed asset accounts such as the construction of theaters. Preproduction costs, which include costs for advertising, sets and costumes, are incurred prior to the opening of the production. According to Livent’s accounting policy, as contained in its financial statements, preproduction costs are expensed through amortization once a production begins, for a period not to exceed five years. Fixed assets, on the other hand, are depreciated over their useful life, up to forty years for buildings. As a result, Livent significantly decreased show expenses, and inflated profits, by fraudulently amortizing preproduction costs over a much longer period of time (SEC, 1999a: para. 18).

It is estimated that by allocating operating and preproduction costs to fixed assets, Livent expenses were understated by more than $15 million in the mid 1990 (para. 18).

Second, Livent began to arbitrarily move operating expenses from one period to another. According to the SEC,

at the end of each quarter, Livent simply removed certain expenses and the related liabilities from the general ledger, literally erasing them from the company’s books. In the succeeding quarter, the expenses and related liabilities would be re-entered in the books as original entries. This blatant accounting manipulation violated the basic tenets of the Generally Accepted Accounting Principles (GAAP). The amount of expenses moved from current periods to future periods was internally tracked at Livent as the "Expense Roll." This manipulation permitted significant reduction in show expenses while also increasing profits (para. 19).

The SEC noted that “the total expenses rolled from the first to the second quarter of 1997 were approximately $10 million” (para. 19).

Third, Livent was involved in what the SEC referred to as, “amortization roll.” According to the SEC, Livent

transferred costs from one show currently running to another show that had not yet opened or that had a longer amortization period. This accounting manipulation increased profits in a particular quarter by reducing the charge for amortization of preproduction costs, since amortization is only appropriate once a production has begun. For example, in 1996 and 1997, approximately $12 million relating to seven different shows and twenty-seven different locations was transferred to the accounts of approximately thirty-one different future locations and ten other shows then in process (SEC, 1999a: para. 20).

The SEC estimated that “the cumulative impact of these accounting irregularities caused Livent to materially understate expenses” by about $30 million in the mid-1990s (para. 21). Despite
Drabinsky and Gottlieb’s efforts to paint a rosy picture of Livent’s financials, they realized that more manipulation of the records was needed to “embellish the company’s financial data” (Knaap, 2008: 392). So in 1996, Drabinsky and Gottlieb began what the SEC termed, “Fraudulent ‘Revenue-Generating’ Transactions” (SEC, 1999a: para. 35). According to the SEC, from 1996 through 1997, Drabinsky and Gottlieb orchestrated the recognition of at least $34 million in revenue by entering into side agreements on transactions that required Livent to pay back monies it received. Most of these transactions involved the sale of rights to present Livent’s theatrical productions in return for specific fees paid by counter parties. Without the side agreements, the underlying sales agreements made little economic sense for the other parties: the fees were nonrefundable and the parties only obtained limited profit participation from productions which Livent had no obligation to make available for presentation (para. 35).

The SEC estimated that “Livent fraudulently overstated revenues in its financial statements by $16.4 million for fiscal year 1996 and $17.6 million for fiscal year 1997 as a result of these undisclosed side agreements” (para. 36).

c. Why was the Fraud not Discovered?

The corporate culture that was in place at Livent was not conducive to effective controls. Livent, it is argued, had an “extremely aggressive, growth-oriented management team”, with a “corporate culture” that was classified by Madam Justice Benotto of the Ontario Superior Court, as “one of dishonesty” (Knaap & Knaap, 2009: 31; R. v. Drabinsky, 2009: 52; also see Hemraj, 2004: 268-269). Drabinsky was mostly interested in the company’s bottom-line and warned the accountants at Livent, “not to provide certain financial information until he had reviewed and approved it” (Knaap, 2008: 390). It is noted that Drabinsky usually directed the amount to be arbitrarily adjusted for each reporting period. On one particular occasion, Messina met with Drabinsky to show him an estimate of Q2 earnings for 1998 that “indicated a loss of $13 million” to which he replied, "… these numbers are [expletive] up… You don’t know what the [expletive] you are doing… You can’t show these to anyone” (Brooks & Dunn, 2007: 406). Drabinsky then demanded that the loss be reduced to $200,000 (p. 406). Given Drabinsky’s “abusive and profane management style” a culture of fear was created within the corporation (Knaap, 2008: 391). Accountants at Livent were scared of Drabinsky and more often than not, agreed to his “arbitrary adjustment” of the books in each “reporting period” (SEC, 1999b: para. 5). Webster, “reported that the accountants sometimes left meetings with Drabinsky in tears or even nauseous” (Knaap, 2008: 391). Webster went on to note that, “following one such meeting … [he] recalled Messina ‘shaking like a leaf’” (p. 391).

Given that the magnitude of the fraud was growing “steadily throughout the 1990s, the company’s accounting staff found it increasingly difficult to provide meaningful financial data to top management” (Knaap, 2008: 393). As the sheer volume and dollar amount of the manipulation increased, “it became necessary for senior management to be able to track both the real and the phony numbers” (p. 393). Gordon Eckstein (“Eckstein”), the Company’s Senior Vice-President of Finance and Administration and Messina’s superior, “allegedly instructed a subordinate”, Raymond Cheong (“Cheong”), Livent’s manager of information technology, “to develop a computer software [program] that would solve this problem” (p. 393). Eckstein instructed two senior controllers at Livent, Diane Winkfein (“Winkfein”) and Grant Malcolm
(“Malcolm”), to make the adjustment in “the company’s accounting system using [the new] computer program which allowed them to make the adjustments without a trace in order to hide the fraud from the company’s auditors (SEC, 1999b: para. 5). The purpose of the software was to make sure that Livent could record fraudulent transactions, “without leaving a paper trail that Livent’s outside auditors might stumble across” (Hiltzik and Bates, 1999: para. 7). To facilitate this purpose, Eckstein’s instructed Malcolm to “maintained separate records showing the adjustments, so that senior management could track the manipulations and know Livent’s true financial condition” (SEC, 1999b: para. 5). The accountants were told by Livent executives to “process” the “illicit changes” in a “batch mode” on the accounting records (Knaap, 2008: 393). Consequently, “when … [the] ‘adjustments’ were processed, they replaced the initial journal entries for the given transactions, making the adjustments appear as if they were the original transactions, thus duping the company’s Deloitte auditors” (p. 393).

A more sinister problem concerns those who were in charge of internal control at Livent. It is reported that Livent’s senior control and accounting staff, along with members of the management team, were directly involved in the manipulations. According to the SEC, “after the adjustments were processed, Winkfein or Malcolm provided Eckstein with an adjusted general ledger containing the accounting manipulations” (SEC, 1999c: para. 24). Drabinsky and Gottlieb, along with the “active participation” of other senior members of the control staff, namely Eckstein and Robert Topol (“Topol”), the company’s former Senior Executive Vice-President and Chief Operating Officer, and later on Messina, usually met to “review manipulated results” (para. 24). The SEC noted that “Drabinsky would direct any further adjustments, which Winkfein or Malcolm processed in the accounting system, at Eckstein’s direction” (para. 24). Senior management would then do a final review of the manipulated records, after which, “bogus numbers were presented to Livent’s audit committee, the auditors, investors, and eventually filed with the Commission” (para. 24).

3. Investigative Steps for Financial Crime Investigators

a. Determining Whether or not Fraud Occurred

Before one can carry out a full-fledged investigation of a fraud, it is important for the investigator to first determine whether an incident has in fact occurred. To accomplish this task, the investigator initially needs to collate information on the “material facts” of the incident (also see Crawford and Weirich, 2011: 356-359). Similar to what Webster did, the investigator should request copies of all of the financial records prepared by Livent’s accountants to date, and along with Certified Fraud Examiners (CFE), comb through them for fraudulent activities. Given that management would be reluctant to allow for discovery of the accounting records (as was the case in Livent), the investigator should make attempts to begin by informally discussing the impending fraud with the accountants headed by Messina, and her immediate subordinates. Assuming that the others in charge of accounting and finance (Topol and Eckstein) would be willing to speak with the investigator, he/she should also interview them to gather any information that would be useful in the investigation.

The investigator should expect to find discrepancies in the financial statements related to the kickback scheme that Drabinsky and Gottlieb operated with Livent vendors, Kofman and
Wayment. As canvassed before, the investigator should also expect to find discrepancies related to expense rolls, where Livent accountants manipulated the books by, “arbitrarily moving operating expenses from one period to another”; amortization rolls, where Livent’s accountants, “failed to subtract expenses that were supposed to be amortized by moving them to other periods”; show-to-show transfers, where the accountants, “applied the expenses of one show to another”; transfers to fixed assets, where, “operating and preproduction costs” were allocated “to fixed assets accounts related to theatres and buildings under construction”; and finally ticket purchases, where, “a portion of tickets purchased” were allocated “on Livent’s behalf by suppliers to asset accounts” (R. v. Drabinsky, 2009: 43).

b. Who was Responsible?

It is to be expected that those directly responsible would be reluctant to give information on the alleged fraud, or if they do cooperate, they would provide distorted information and blame the other parties. As such, the investigator should start from the bottom of the finance and control department’s hierarchy. The investigator should first identify and interview accountants responsible for the day-to-day operations of Livent. Any information obtained from these interviews would be used to formulate questions that would be used later on to do targeted interviews with those in senior positions at Livent, namely Drabinsky and Gottlieb (if they cooperate), Eckstein, Messina, and Topol. The investigator should also interview Livent’s two vendors Kofman and Wayment, for information on the kickback scheme. The investigator should peruse the various executive summaries and reports related to construction projects, production, as well as memos, share certificates belonging to Drabinsky and Gottlieb, financial records related to revenue transactions, cash management, and corporate finances, to see who prepared and signed off on these documents.

From the interviews and corporate records, the investigator should expect to find the mastermind(s) of the fraud. More specifically, he/she should expect to pinpoint those that were directly responsible, and the extent to which they were involved, in the accounting manipulation. Drabinsky, Gottlieb, Eckstein, Messina and Christopher Craib (“Craib”), another senior controller at Livent, were all key players in both the day-to-day management and operation of the Company. Their signatures should be on the documents reviewed and they would have to explain any discrepancies in these documents. The interviews and review of the accounting records would also establish the motives of the parties involved. It would be expected that since Livent was already in need of revenue, those directly in charge of preparing the financial statements would maximize net income to paint a favorable picture of the company in order to continue receiving high salaries (and possible bonuses).

c. The Nature and Extent of Any Losses

To secure information on the nature and extent of the losses, a thorough examination of all financial statements and other records prepared from Livent’s inception to the date the fraud was discovered (1994), would be required. Past financial statements can be retrieved from the Company itself, or government electronic databases. The investigator should also look at related invoices and cheques signed by Drabinsky and Gottlieb, the general ledger, reports from shows, schedules of preproduction costs, cash flow statements, and statements prepared for the meetings
with Drabinsky, Gottlieb and the senior accountants. The investigator should find out who the manufacturer was for the software that was used to eliminate the audit trail, to see if there was a way for him/her to retrieve the original information.

It is expected that the investigator would find bogus invoices for construction related expenses and inflated balance sheets. Cash flow statements would be out-dated and financial statements would be distorted, because the original filings would show the manipulated numbers, whereas the other ones used in the executive meetings would show the actual performance of the company. More specifically, the latter would show the “Net Income Reported” and the “Actual Net Income” of Livent (R. v. Drabinsky, 2009: 97). The general ledger would show the manipulations and the adjustments that were made to Livent’s statements. The hidden expenses in the form of “millions deleted from accounts payable and millions capitalized to fixed assets” (p. 97), would become transparent, as well as the aggressive revenue recognition of the unknown large transactions that Drabinsky and Gottlieb were involved in (Knaap, 2008: 395). Finally, with the assistance of the manufacture(s) of the software, the investigator should expect to retrieve data on the general ledger accounts.

4. Lessons learned: Implications to Corporate Environments

   a. Implication for Management: the Need for a Contingency Plan

   It was clear from the investigation of this case that Livent did not have a contingency plan in place to deal with fraud. Also, external auditors were not trained to detect the fraud and in some cases, may have been seen as, “necessary evil” (SEC, 1999c: para. 25). Given the circumstances in which the Livent fraud unfolded, public companies should ensure that a contingency plan is in place to protect the company from fraudulent activities. Comer sets out some of the requirements that a contingency plan should have (Comer, 1998: 347-348). Briefly put, Comer noted that a contingency plan should ensure that members of the company's internal security team contact the “commercial crime branch and regulatory enforcement team that operate” in the company’s country, and brief them about the company and potential problems (p. 347). Assuming that the companies have fidelity insurance, it should be verified to make sure that it covers all categories (p. 347). More importantly, Comer noted that a procedure should be set up to report incidents of fraud (p. 348). In many cases, the employees are “immobilized by fear”, while in others, there might be a multitude of factors that prevent the employee(s) from reporting the fraud (Brooks and Dunn, 2007: 406). Once safeguards are in place to protect whistleblowers, it is expected that they will report the fraud and as Comer pointed out, they should have “no excuse if they fail to do so” (Comer, 1998: 348).

   b. Implication for Senior Financial Officers

   The Livent scandal has implications for senior financial officers who prepare financial statements in large corporations. One of the first questions that come to mind is: what should an accountant do when faced with a situation similar to Messina? Since the internal audit committee and corporate management were all in some way or another, involved in the fraud, it makes no
sense to report the fraud to these individuals. Should she have proceeded to report the fraud to her colleagues at Deloitte or inform the RCMP? Messina was faced with three options: first, report the fraud to senior management; second, report the fraud to the police and, third, contact the auditors. Comer chronicled a host of reasons as to why none of the above should be contacted unless the objectives of the investigation are fully determined (Comer, 1998: 406). In this situation, there were circumstances that prevented Messina from reporting the fraud. Chief among them was that even senior management and those from the internal auditing committee, were involved in the fraud (see Hemraj, 2004: 268-269). Assuming that an ethics policy is not already in place, public companies should take note of what occurred in Livent and implement a mandatory “code of ethics”, similar to that stipulated by the Sarbanes-Oxley Act (“SOX”) in the U.S., to govern the conduct of “senior financial officers” (Wells, 2007: 344). If “there is a change in the code of ethics or a waiver of the code of ethics for a senior financial officer”, then it should be disclosed (p. 344). Having an ethics policy in place may serve as a deterrent, and when cases of fraud occur, it will at least, “make enforcement of conduct generally easier to legally justify” (p. 414). It does not matter whether the fraud is material or not, it should be brought to the attention of the company’s senior management. Even if senior management is also involved, seek out someone from the management team who is not involved and can be trusted with the information. In the case where no one can be trusted, then contact the police immediately.

c. **Implications for Internal Audit**

Companies should see to it that the internal audit committee is independent and functions without interference from top management (Brennan and McGrath, 2010: 59). The case for an independent internal auditing committee stems from the fact that “it has an advantage over external auditors, being continuously present in the organization and thus better able to form a judgment about the control environment” (p. 59). Moreover, it is expected that the lines of communications between the internal and external auditors are open and transparent at all times (p. 59).

d. **Implications for External Auditors**

Just as important, is the role of the external auditors in conducting their yearly audits. Corporations should make sure that there is no inherent conflict-of-interest with their senior officers and the external auditors, and give them the independence to do their job (see Pallisserry, 2012: 336-338). Unlike Livent, procedures should be in place to make sure auditors are never kept in the dark on corporate transactions. One such procedure is to make sure that there is an audit trail so that the auditors can trace all transactions through the books. External auditors should be encouraged to report all red flags. The corporation should see to it that the external auditors understand their role as watchdogs, and report all suspicious transactions uncovered to corporate management (Comer, 1998: 13-14; Pallisserry, 2012: 336-338). Particular attention should be paid to areas such as revenue recognition, where manipulations are easier and more likely to occur (Brennan and McGrath, 2010: 59). More specifically, external “auditors should consider any unusual revenue patterns in their efforts to detect fraud” (p. 59). Auditors should be aware of the fact that “revenue increases before the end of a quarter, or
revenue patterns that do not fit the business cycle, could be an indication of something untoward” (p. 59).

**Conclusion**

The Livent fraud was multifaceted and showed how the abrasive nature of one of its owners, Drabinsky, was able to circumvent legislation and internal control procedures to maximize profit. The fraud also highlighted a more sinister problem, in that it demonstrates how the individuals in charge of the day-to-day operations of a company, can collude to maximize their interests at the expense of investors and creditors. By recounting the sequence of the fraud, the factors that led to its discovery were made transparent. Corporate frauds do not occur in a vacuum; they are well drawn out, planned over time, and executed with utter disrespect for the investors. In illustrating whether an incident had in fact occurred, the information provided was also able to show the parties responsible and the nature and extent of the losses incurred. The Livent fraud also demonstrated that the parties responsible would have gone to any lengths to cook the books, in order to present a “rosy” picture of the Company’s financial statements. Finally, the additional control weaknesses that allowed the fraud to occur, serve as a lesson for management in other corporate environments to implement policies that will minimize fraudulent activities. What is important to note here, is that those in charge of preparing the company's financial statements, must be held fully accountable (along with senior management) for any discrepancies in the records. At no point in time should management claim willful blindness when questioned on the accuracy of the financial statements. In closing, it would be wise for management to adhere to the words of the ancient Greek tragedians Sophocles: [t]hings gained through unjust fraud are never secure.”
Notes

1 To peruse the timeline on how the Livent's fraud unfolded, see Heaven (2009).

References


R. v. Drabinsky, 2009 CanLII 12802 (ON S.C.)


