Journal of Forensic & Investigative Accounting
Vol. 6, Issue 1, January - June, 2014

Duplicity and Diligence: An Ethical Forensic Case Study of International Espionage

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No doubt, Guy Enright was apprehensive as he talked to the mysterious stranger on the phone. At the time, Enright, a British citizen and Chartered Accountant, was working on an unusual engagement for his employer, KPMG.[1] The Big Four accounting firm had been appointed by Bermuda's Minister of Finance to review and report on the financial affairs of a large investment fund, IPOC International Growth Fund, Ltd. (IPOC). Although based in Bermuda, a Danish attorney, Jeffrey Galmond, served as the company's chief executive and was reportedly its principal stockholder.

The individual who had called Enright identified himself as Nick Hamilton. During the phone call, Hamilton told Enright that he needed to speak to him about a matter that had "national security implications for Britain" (*Bloomberg Businessweek*, 2007). Hamilton, who had a strong British accent, "led Enright to believe he was a British intelligence officer" (*Bloomberg Businessweek*, 2007) and apparently asked Enright not to tell his superiors that he had contacted him.

After considering the strange request for a few moments, Enright agreed to meet with Hamilton in a public place. Hamilton then arranged for the two of them to have lunch a few days later at Little Venice, a popular Bermuda restaurant.

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[1] Much of the background information for this case was taken from the following source: *Bloomberg Businessweek*, "Spies, Lies & KPMG," www.businessweek.com. 25 February 2007. Instructional teaching notes for this case are available upon request. Contact Michael Knapp at the University of Oklahoma (mknapp@ou.edu)

I. BERMUDA SHELL GAME

A former Merrill Lynch executive organized IPOC in 2000 after the Bermuda government issued a license to the company to operate as a mutual fund. Three years later, after Bermuda regulatory authorities discovered that the company's founder was a convicted felon, he was dismissed and Jeffrey Galmond took control of the company.

Over the next few years, IPOC grew dramatically. The company's principal investments were in Russian telecommunications companies that were a product of the Russian Federation's "privatization programme" during the 1990s. That program converted thousands of state-owned agencies within the former Soviet Union into privately owned companies and was intended to distribute the ownership interests of those new companies to millions of Russian citizens. The majority of those ownership interests, however, were usurped by individuals who had held high-ranking positions in the former Soviet government or who were friends, family members, and business associates of such individuals.

By 2004, the Bermuda government was alarmed by rampant rumors and allegations that IPOC was not operating as a mutual fund but rather was a money-laundering "criminal" enterprise. Critics of the company insisted that Jeffrey Galmond and other IPOC executives served only as figureheads and that IPOC was actually owned and controlled by Leonid Reiman, Russia's Telecommunications Minister.

Reiman was a longtime friend and close ally of Russian president Vladimir Putin who had appointed him to oversee Russia's emerging telecommunications industry. Allegedly, Reiman had used his position to take control of Russia's key telecommunications companies and place them under the IPOC corporate umbrella. Reiman disputed such claims and insisted that he was not involved with IPOC and that Galmond was the company's principal executive and owner.

To squelch the controversy, IPOC's management hired Ernst & Young to "audit" its business affairs and issue a report on its findings. Copies of the Ernst & Young report obtained by third parties caused even more questions to be raised about IPOC's legitimacy. This E&Y report documented a number of suspicious cash transfers that appeared to have no credible business purpose.

For decades, Bermuda's political leaders have taken strenuous measures to prevent their country, which is technically a British territory, from becoming a headquarters for companies controlled by organized crime syndicates. Several small nations in the nearby Caribbean, on the other hand, have bank secrecy laws that serve as an invitation to such enterprises. Increasing concern regarding the true nature of IPOC's operations goaded Bermuda's Minister of Finance in 2004 to retain KPMG to investigate the company. Two years would pass before the investigation and its findings would be publicly reported. In the meantime, another headline-grabbing controversy involving IPOC erupted.

II. CELL PHONE MANIA

In late 2003, IPOC filed a lawsuit against the Alfa Group, a Russian-based company that was attempting to become a major competitor in Russia's mobile phone industry. At the time, IPOC owned, directly or indirectly, a 40 percent interest in one of Russia's largest cell phone companies, MegaFon. Over the previous few years, IPOC had attempted to gain a majority ownership interest in MegaFon by purchasing the 25 percent stake in the company held by Leonid Rozhetskin, a U.S. citizen of Russian descent. IPOC also named Leonid Rozhetskin as a defendant in the lawsuit it filed.

In 1992, Leonid, a 26-year-old Harvard Law School graduate, accepted a job with the Moscow office of a U.S. law firm. Rozhetskin soon left his legal career behind to become a venture capitalist. In 1996, he was involved in registering VimpelCom, a Russian telecommunications company on the New York Stock Exchange, the first Russian company to be listed on the "Big Board."

Among Rozhetskin's investment partners were George Soros, a billionaire American financier, and Mikhail Fridman, one of Russia's wealthiest businessmen. Both Soros and Fridman were longtime antagonists of Vladimir Putin. In 2000, Putin, a former agent in the Soviet Union's notorious intelligence agency, the KGB, had been elected president of the Russian Federation, succeeding his mentor Boris Yeltsin, the Federation's first president.

Unlike his two wealthy colleagues, Rozhetskin, was openly critical of President Putin and his economic policies. The controversial and ambitious Rozhetskin also maintained a high profile in Russia's nascent investment community. Because of his aggressive persona, the Russian version of *Forbes* magazine placed him on its cover under the caption, "The Most Dangerous Shark in Our Waters" (*PRNewswire*, 2006).

IPOC officials sued Alfa Group and Rozhetskin because they insisted that they had negotiated a binding agreement with Rozhetskin that required him to sell his 25 percent ownership interest in MegaFon to their company. Rather than selling his stake in MegaFon to IPOC, Rozhetskin unexpectedly sold it to the Alfa Group in August 2003. Rozhetskin's decision would ultimately trigger the filing of a series of lawsuits and countersuits over the next several years involving IPOC, Alfa Group, and Rozhetskin in British, Russian, Swedish, Swiss courts. The bruising legal battle eventually convinced Bermuda's Minister of Finance to hire KPMG to investigate IPOC.

III. LUNCH AND LIES

When Guy Enright showed up at the Little Venice restaurant in Bermuda for his luncheon meeting with Nick Hamilton, he was greeted not only by Hamilton but also by an attractive young lady who introduced herself as "Liz from Langley." No doubt, Enright took "Langley" to mean Langley, Virginia, the headquarters of the U.S. Central Intelligence Agency (CIA). Hamilton explained to Enright that he was needed to assist in a "top secret" mission that "involved Britain's national security."

> [Hamilton] . . . told the accountant he would have to undergo a British government background check to ensure that he was up to the task. [Hamilton] produced an official-looking—but fake—questionnaire with a British government seal at the top and asked for information about Enright's parents, his professional background, any criminal history, and political activities (*Bloomberg Businessweek*, 2007).

A few weeks later, Hamilton and Enright met again at a Bermuda bar. During this meeting, Hamilton told Enright he was being recruited to provide information about KPMG's audit of IPOC. Hamilton convinced Enright to begin "handing over confidential audit documents, including transcripts of interviews KPMG had conducted in the IPOC investigation" (*Bloomberg Businessweek*, 2007). Enright was instructed to place those documents in a plastic container hidden under a large rock in a secluded area on Bermuda. Hamilton would then retrieve those documents.

In fact, Nick Hamilton was not a British intelligent officer, and "Liz" was not a CIA agent as they had led Enright to believe. Instead, Nick Hamilton was actually Nick Day and "Liz" was Gretchen King, one of Day's subordinates. Day was a senior executive of Diligence, Inc., a London-based "business intelligence" firm that he had founded in 2000; King was assigned to Diligence's New York City office. Day did have a background in government intelligence, having served with the United Kingdom Special Forces, a secretive agency of the British government that deals with counter-terrorism and other threats to Britain's national security. Day currently serves as the CEO of Diligence, Inc.[2]

During the legal battle over Leonid Rozhetskin's 25 percent ownership interest in MegaFon, the Alfa Group had hired Barbour Griffith & Rogers (BGR),[3] a Washington, D.C.-based lobbying firm. In turn, BGR had hired Diligence, which maintained an office in Washington, D.C., two blocks from the White House. BGR wanted Diligence to obtain information regarding IPOC that would help Alfa Group retain the 25 percent ownership interest in MegaFon that had been purchased from Rozhetskin.

On its website, Diligence states that it is a "business intelligence firm that helps its clients confront difficult business challenges." The website goes on to note that, "In this role, we provide companies with both the intelligence and analysis to enable them to identify, manage and mitigate risks stemming either from the normal flow of business or from unanticipated contingencies." In laymen's terms, a major focus of Diligence's business model is helping multinational companies deal with threats posed by corporate espionage, real or imagined.

William Webster, the only individual to have served as the head of both the Federal Bureau of Investigation (FBI) and the CIA, served for many years on Diligence's Advisory Board and reportedly helped Nick Day organize the firm in 2000. In 2006, Michael Howard was appointed Diligence's chairman. For several years, Howard had served as the leader of

[2] Nick Day also served for a time as a special consultant to the popular British TV series *Spooks*, a drama that revolves around the trials and tribulations of a British domestic intelligence organization.

[3] BGR was co-founded by the prominent politician Haley Barbour. In 2000, *Fortune Magazine* named BGR as the nation's most powerful lobbying firm.

Britain's Conservative Party and would have become the nation's Prime Minister if his party had been successful in defeating the Labour Party headed by Tony Blair.

Unknown to Guy Enright, he had been the focal point of a months-long effort by agents of Diligence to gain inside information regarding IPOC. Diligence's management intended to complete this assignment, which it referred to as Project Yucca, in secrecy to avoid any embarrassment or legal repercussions for itself, Alfa Group, or BGR. An internal memo of Diligence obtained by *Bloomberg Businessweek* noted that, "We are doing it [Project Yucca] in a way which gives [us] plausible deniability, and therefore virtually no chance of discovery" (*Bloomberg Businessweek*, 2007).

After being retained by BGR, Diligence went to great lengths to identify one or more individuals who might cooperate in its effort to gain access to IPOC's inner sanctum. When Diligence learned that KPMG was involved in a government-sponsored investigation of IPOC, they contacted staff members of KPMG's Bermuda office. While posing as organizers of a legal conference in Bermuda, two Diligence employees were successful in eliciting from KPMG's secretarial staff the names of the individuals assigned to the IPOC engagement.

Next, Diligence developed psychological profiles to identify the KPMG employees most likely to participate in the agency's covert plan. According to *Bloomberg Businessweek*, the female profile suggested that Diligence should target "a young female who is insecure . . . not honest. Someone who spends money on her looks, clothes, gadgets. Has no boyfriend, and only superficial friends. Has a strong relationship with her mother" (*Bloomberg Businessweek*, 2007). The similarly unflattering male profile involved a "male in his mid-20s who is somewhat bored . . . has a propensity to party hard, needs cash, enjoys risk, likes sports, likes women, is disrespectful of his managers, fiddles his expenses, but is patriotic" (*Bloomberg Businessweek*, 2007).

After determining that none of the KPMG employees assigned to the IPOC engagement was a good "fit" for the ideal male or female personality profiles that they had developed, the Diligence officials decided to focus their attention on Guy Enright. Throughout the several months required to carry out Project Yucca, the intelligence firm went to great lengths to insure that Enright was not a "double agent" acting on behalf of IPOC. The counter-intelligence measures they employed included tracking Enright as he traveled around Bermuda and searching his garbage.

For its efforts, Diligence was paid $280,000 by BGR and was reimbursed for $30,000 of expenses it incurred. Included in the $280,000 figure was a $60,000 "bonus" paid to Diligence when Nick Day convinced Enright to hand over an early draft of KPMG's report on its IPOC investigation. For his role in the clandestine operation, Enright was given a Rolex watch valued at "thousands of dollars" by Diligence and "was led to believe that it [the watch] was a thank-you gift from the British government" (*Bloomberg Businessweek*, 2007).

IV. EPILOGUE

In July 2007, IPOC and Alfa Group announced that they were ending their long-running and costly legal battle. The two companies agreed to "end all court actions and renounce legal claims against each other" (Buckley, 2007), which meant that the Alfa Group would retain the 25 percent ownership interest in MegaFon that it had purchased from Leonid Rozhetskin. By this time, however, IPOC's cover "had been blown." The year before, a Swiss arbitration panel had corroborated one of the key allegations made by Alfa Group against IPOC, namely, that Leonid Reiman, Russia's Telecommunications Minister and

Vladimir Putin's close ally, was IPOC's "beneficial owner" (Buckley, 2007). A similar conclusion was reached by a law enforcement agency in the British Virgin Islands that also had been investigating IPOC. That agency reported that IPOC "was a front for the laundering of the proceeds of crime of, amongst others, Russian Telecommunications Minister Mr. Leonid Reiman" (Kent, 2008).

In May 2008, after reviewing KPMG's report on IPOC and information culled from other sources, the Bermuda Supreme Court ruled that IPOC had to disband its business operations in Bermuda. In commenting on that ruling, Bermuda's Finance Minister observed that, "We were committed to protecting Bermuda and sending a signal to the world that Bermuda does not trifle with its reputation" (Kent, 2008). The relieved and happy official then added that the "long and complicated case" had "more angles and twists and turns than a James Bond novel" (Kent, 2008).

In late 2005, a bundle of documents that revealed the details of Diligence's "sting operation" involving Guy Enright had been left anonymously at a New Jersey office of KPMG.[4] After reviewing those documents, the Big Four accounting firm filed a civil lawsuit against the British intelligence firm. Although that lawsuit was settled privately between the two parties, numerous sources reported that Diligence paid KPMG $1.7 million to resolve the matter. Despite that settlement, Diligence officials insisted that they had done nothing wrong during the infamous Project Yucca. Those officials reported that they had "obtained information [regarding IPOC] from a whistleblower worried that the inquiry [of IPOC by KPMG] might bury some uncomfortable facts" (Fidler *et al.*, 2006).

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[4] Several parties have speculated that a disgruntled former employee of Diligence, Inc. was the individual who delivered these documents to KPMG.

The details of Diligence's sting operation were leaked to the press in late 2006 and early 2007. By this time, Guy Enright had left the employment of KPMG and joined the consulting staff of Deloitte & Touche in London. At last report, he was still employed by Deloitte.

Throughout the drawn-out legal battle involving himself, Alfa Group, and IPOC, Leonid Rozhetskin continued to be an outspoken critic of the Russian government, particularly Vladimir Putin. In late 2006, a Russian federal prosecutor filed criminal charges against Rozhetskin and issued an arrest warrant for him. The prosecutor alleged that Rozhetskin had engaged in wide-ranging fraudulent activities related to the sale of his 25 percent ownership interest in MegaFon to Alfa Group. After the arrest warrant was issued, "Rozhetskin maintained that his life was in danger for seeking to expose corruption of President Putin's government" (Gain, 2012).

In March 2008, Rozhetskin disappeared while making a business trip to Latvia. Over the next few years, Russian law enforcement authorities insisted that Rozhetskin had been placed in the federal witness protection program by U.S. law enforcement authorities and was living under an assumed name in California where he had become involved in the movie industry as a producer. Rozhetskin's mother dismissed that rumor and maintained instead that her son had been abducted by Putin allies. She claimed that he had been abducted because of his public criticism of Putin and because he was planning "a documentary film that would expose government and business corruption in Russia" (Gain, 2012). Four years later, in September 2012, DNA tests revealed that skeletal remains discovered in a remote area of Latvia were those of Leonid Rozhetskin.

V. QUESTIONS

1. Bermuda's Minister of Finance retained KPMG to "audit" the business affairs of IPOC to determine whether the company was a criminal enterprise or a legitimate business operation. What type of professional service was KPMG providing during this engagement? Did the engagement qualify as an assurance, attestation, audit, or consulting engagement? Defend your answer.

2. What moral, ethical, and professional responsibilities did Guy Enright face when he was asked to turn over confidential documents to the individuals who were representing themselves as intelligence agents for the British and U.S. governments? Which of those responsibilities did he violate and which did he uphold?

3. Compare and contrast the conduct of Guy Enright and Nick Day. Which of these individuals was most ethical (or least unethical)? Defend your answer.

4. How would you respond if you faced a set of circumstances similar to those faced by Guy Enright?

5. Do you believe that Deloitte & Touche should have hired Guy Enright after he left the employment of KPMG? Explain.

6. A Russian prosecutor alleged that Leonid Rozhetzkin engaged in various fraudulent activities, which included reneging on his commitment to sell his 25 percent ownership interest in MegaFon to IPOC. Define the legal meaning of "fraud." Given this definition, under what condition or conditions would Leonid Rozhetzkin have committed a fraudulent act by selling his ownership interest in MegaFon to Alfa Group rather than IPOC? Defend your answer.

7. KPMG filed a civil lawsuit against Diligence, Inc., in 2005 after learning of the "sting operation" that firm had perpetuated on Guy Enright. What rationale or legal principles would have been the basis for that lawsuit? Do you believe that KPMG would have been successful if it had pursued that lawsuit rather than settling it out of court? Assuming that KPMG believed it would ultimately win a civil judgment against Diligence, why would the accounting firm choose to settle the lawsuit out of court? Explain.

8. Define what is meant by the phrase "money laundering." Identify types of forensic investigations that would commonly target money laundering activities.

If you would like the Teaching Notes to this case, please contact either of the authors.

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