



## **FORENSIC ACCOUNTING TOOLS**

### **WHAT'S NEW!**

**Charles L. Kern, BS/MBA/CPA/CVA/CFA/AEP/ABV/CFF/FCPA**

### **BENFORD'S LAW**

#### **I. BACKGROUND**

- A. Who was Frank Benford?
- B. Benford's Law Defined
- C. First/Second Digit Distribution Table
  1. Lower numbers (1-3) occur more frequently as a first digit than higher numbers
  2. Second Digit: numbers 0-9 typically occur with a more even distribution, with each number appearing between 8%-12% of the time

#### **II. ADVANTAGES**

- A. Simple, effective way to uncover fraud in accounting numbers
- B. Can be used by auditors as analytical procedures in the planning stage of audits to help identify potential high risk areas.
- C. Can help to identify operational discrepancies
- D. Used by the IRS/FBI/State Revenue Departments as a means to detect potential tax fraud

#### **III. DISADVANTAGES**

- A. Must have a sufficient sample size
- B. Not all data samples are appropriate for analysis
- C. Not a "surefire" way to catch fraud

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### **IRRATIONAL TREND RATIOS**

- I. DESCRIPTION
  - a. Ratios calculate the change from one year to the next for several key areas
  - b. A material trend of significant increase or decrease over a four or five year period is deemed to be irrational or odd and should be investigated further
- II. ADVANTAGES
  - a. Simple tool that can highlight potential inflation/manipulation of financial figures
  - b. Minimal time and cost involved
  - c. Can be used by auditors as analytical procedures in the planning stage of audits to help identify potential high risk areas
- III. DISADVANTAGES
  - a. Some trends may not be an indication of number manipulation and/or potential fraud
  - b. Typically need several years of data for the ratios to be effective

### **CAUSAL RATIOS**

- I. DESCRIPTION
  - a. Causal Ratios that tend to reveal the cause of conditions—good or bad
  - b. Effect Ratios that tend to show the impact of management decisions and actions
- II. ADVANTAGE—Investigative efforts are focused
- III. DISADVANTAGES
  - a. Analysis tends to be complex, subtle, and a bit vague
  - b. The causes revealed tend to be complex and subtle

### **THE DYNAMIC DUO—A CASE STUDY**

**FIRST FRAUDSTERS, INC.**  
**EXHIBIT 1**  
**Balance Sheet**

	6/30/2005	6/30/2004	6/30/2003	6/30/2002	6/30/2001
<b>Current Assets</b>					
Cash	780	757	3,058	10,852	4,263
Accounts receivable, trade (net of allowance)	457,139	732,032	525,459	446,952	551,208
Accounts receivable, refunds			7,360	12,581	-
Accounts receivable, other	1,210	1,470	2,118	2,142	128
Inventories (at cost)	560,251	701,269	611,460	570,834	717,912
Prepaid taxes	3,644	6,224	15,976	20,578	84,024
Prepaid expenses, other	68,807	59,808	35,876	42,299	32,300
Related party receivables	19,833	3,424	3,674	5,587	-
<b>Total Current Assets</b>	<b>1,111,664</b>	<b>1,504,984</b>	<b>1,204,981</b>	<b>1,111,825</b>	<b>1,389,835</b>
<b>Property and Equipment:</b>					
Land	17,233	17,233	17,233	17,233	17,233
Plant and equipment	6,405,346	6,136,843	6,010,746	5,905,038	5,834,580
Accumulated depreciation	(5,605,283)	(5,357,334)	(5,043,496)	(4,717,531)	(4,370,709)
<b>Total Property and Equipment</b>	<b>817,296</b>	<b>796,742</b>	<b>984,483</b>	<b>1,204,740</b>	<b>1,481,104</b>
<b>Other Assets:</b>					
Organization costs	725	725	725	725	725
Deferred tax assets	72,595	43,907	23,989	-	-
<b>Total Other Assets</b>	<b>73,320</b>	<b>44,632</b>	<b>24,714</b>	<b>725</b>	<b>725</b>
<b>Total Assets</b>	<b>2,002,280</b>	<b>2,346,358</b>	<b>2,214,178</b>	<b>2,317,290</b>	<b>2,871,664</b>
<b>Current Liabilities:</b>					
Accounts payable	275,499	599,564	318,128	332,829	279,577
Accrued payroll	24,535	25,650	27,091	10,099	19,433
Payroll taxes accrued and withheld	7,515	6,752	6,546	12,207	50,990
Customer deposits			213	58	213
State corporate taxes payable	1,531	2,203	2,598	3,048	3,657
State sales tax	747	115	237	97	311
Deferred revenues		-	3,208	6,073	
Note payable, line of credit	454,000	610,000	490,458	168,083	277,931
Current portion of long term debt	27,717	9,477	122,279	147,286	
<b>Total Current Liabilities</b>	<b>791,544</b>	<b>1,253,761</b>	<b>970,758</b>	<b>679,780</b>	<b>632,112</b>
<b>Long-Term Liabilities</b>					
Mortgage payable	345,004	354,161	346,763	453,860	553,265
Note payable, Bank	131,922	-	-		
Note payable, Other Bank			6,402	39,356	74,854
Note payable, Other					1,245
Notes payable, individuals	609,737	566,429	576,920	571,351	717,084
<b>Total Long-Term Liabilities</b>	<b>1,086,663</b>	<b>920,590</b>	<b>930,085</b>	<b>1,064,567</b>	<b>1,346,448</b>
Deduct: Current Maturities	(27,717)	(9,477)	(122,279)	(147,286)	-
<b>Net Long-Term Liabilities</b>	<b>1,058,946</b>	<b>911,113</b>	<b>807,806</b>	<b>917,281</b>	<b>1,346,448</b>
<b>Other Liabilities:</b>					
Security deposits	3,320	4,616	4,366	3,165	3,336
Deferred rental revenues					3,208
Deferred income tax liability	-	-	-	26,829	29,770
<b>Total Other Liabilities</b>	<b>3,320</b>	<b>4,616</b>	<b>4,366</b>	<b>29,994</b>	<b>36,314</b>
<b>Total Liabilities</b>	<b>1,853,810</b>	<b>2,169,490</b>	<b>1,782,930</b>	<b>1,627,055</b>	<b>2,014,874</b>
<b>Stockholders' Equity:</b>					
Capital Stock	53,000	53,000	53,000	53,000	53,000
Capital Paid in Excess of Par Value	219,381	219,381	219,381	219,381	219,381
Retained Earnings	(76,278)	(50,688)	194,834	445,146	599,126
<b>Total Contributed Capital and Retained Earnings</b>	<b>196,103</b>	<b>221,693</b>	<b>467,215</b>	<b>717,527</b>	<b>871,507</b>
Less Treasury Stock	(47,633)	(44,825)	(35,967)	(27,292)	(14,717)
<b>Total Stockholders' Equity</b>	<b>148,470</b>	<b>176,868</b>	<b>431,248</b>	<b>690,235</b>	<b>856,790</b>
<b>Total Liabilities and Stockholders' Equity</b>	<b>2,002,280</b>	<b>2,346,358</b>	<b>2,214,178</b>	<b>2,317,290</b>	<b>2,871,664</b>

**FIRST FRAUDSTERS, INC.**  
**EXHIBIT 2**  
**Statements of Operations**

	6/30/2005	6/30/2004	6/30/2003	6/30/2002	6/30/2001	6/30/2000
<b>Sales, Net of Returns and Allowances</b>	8,296,858	8,359,324	7,889,133	8,559,914	10,127,931	11,089,004
<b>Cost of Materials Sold</b>	5,646,088	5,681,120	5,206,825	5,822,067	9,227,132	7,777,598
<b>Gross Profit</b>	2,650,770	2,678,204	2,682,308	2,737,847	900,799	3,311,406
<b>Operating Expenses:</b>						
Production expenses	1,377,200	1,365,467	1,370,452	2,008,682		1,651,887
Storage and shipping	368,384	370,568	408,392			483,653
Selling expenses	567,179	685,431	677,008			640,521
General and administrative	656,295	605,905	611,431	983,956		676,097
<b>Total Operating Expenses</b>	2,969,058	3,027,371	3,067,283	2,992,638	1,155,242	3,452,158
<b>Operating Loss</b>	(318,288)	(349,167)	(384,975)	(254,791)	(254,443)	(140,752)
<b>Other Income:</b>						
Interest Income	8,006	3,032	10,026	12,894	14,005	2,959
Rental income	87,713	77,645	70,355	83,494	77,403	74,834
Insurance refund	167,825	-		-		
Gain on sale of assets	466	1,705	2,208	-	6,245	
<b>Total Other Income</b>	264,010	82,382	82,589	96,388	97,653	77,793
<b>Loss Before Income Tax Expense</b>	(54,278)	(266,785)	(302,386)	(158,403)	(156,790)	(62,959)
<b>Income Tax Expense/(Benefit)</b>	(28,688)	(21,263)	(52,074)	(4,423)	(46,748)	(16,264)
<b>Net Loss</b>	(25,590)	(245,522)	(250,312)	(153,980)	(110,042)	(46,695)

**FIRST FRAUDSTERS, INC.**  
**EXHIBIT 3**

<b>Causal Ratios</b>	<b>6/30/2005</b>	<b>6/30/2004</b>	<b>6/30/2003</b>	<b>6/30/2002</b>	<b>6/30/2001</b>
Fixed Assets to Net Worth	5.50	4.50	2.28	1.75	1.73
Collection Period	20.11	31.96	24.31	19.06	19.86
Net Sales to Inventory	14.81	11.92	12.90	15.00	14.11
Net Sales to Net Worth	55.88	47.26	18.29	12.40	11.82
Net Profit to Net Sales	-0.31%	-2.94%	-3.17%	-1.80%	-1.09%
Miscellaneous Assets to Net Worth	62.16%	39.27%	12.88%	9.92%	13.58%

**Fixed Assets to Net Worth** - measures over-investment in fixed assets (Fixed Assets/Stockholder's Equity)

**Collection Period** - measures a rise in accounts receivable (AR trade/(Net Sales/365))

**Net Sales to Inventory** - measures a rise in inventory (Net Sales/Inventory)

**Net Sales to Net Worth** - measures overtrading - unrestrained growth (Net Sales/Stockholder's Equity)

**Net Profit to Net Sales** - measures profitability (Net Income/Net Sales)

**Miscellaneous Assets to Net Worth** - measures the rise in "other" assets (Other Assets/Stockholder's Equity)

FIRST FRAUDSTERS, INC.--EXHIBIT 4

	2002	2003	2004	2005
<b>Days' Sales in Receivables Index</b>	<b>Days' Sales in Receivables Index</b>			
$\frac{[\text{Accounts Receivable (c/y)}]/\text{Sales (c/y)}}{[\text{Accounts Receivable (p/y)}]/\text{Sales (p/y)}}$	0.9594	1.2756	1.3148	0.6292
<b>Gross Margin Index</b>	<b>Gross Margin Index</b>			
$\frac{[\text{Sales (p/y)} - \text{Cost of Sales (p/y)}]/\text{Sales (p/y)}}{[\text{Sales (c/y)} - \text{Cost of Sales (c/y)}]/\text{Sales (c/y)}}$	0.2781	0.9407	1.0612	1.0028
<b>Asset Quality Index</b>	<b>Asset Quality Index</b>			
$\frac{1 - [\text{Current Assets (c/y)} + \text{Net Fixed Assets (c/y)}]/\text{Total Assets (c/y)}}{1 - [\text{Current Assets (p/y)} + \text{Net Fixed Assets (p/y)}]/\text{Total Assets (p/y)}}$	0.8000	1.0838	1.2490	0.7387
<b>Sales Growth Index</b>	<b>Sales Growth Index</b>			
$\frac{\text{Sales (c/y)}}{\text{Sales (p/y)}}$	0.8452	0.9216	1.0596	0.9925
<b>Total Accruals to Total Assets Index</b>	<b>Total Accruals to total Assets Index</b>			
$\frac{\text{Change in Working Capital} - \text{Change in Cash} - \text{Change in Current Taxes Payable} - \text{Depreciation and Amortization}}{\text{Total Assets}}$	-0.1387	-0.0762	0.0136	0.0676
<b>Cash flow/ income Index</b>	<b>Cash flow/ income Index</b>			
$\frac{[\text{Income from Operations} - \text{Cash Flow from Operations}](c/y)/[\text{Income from Operations}](c/y)}{[\text{Income from Operations} - \text{Cash Flow from Operations}](p/y)/[\text{Income from Operations}](p/y)}$	#N/A	-2.46241	-4.40296	0.24468

c/y = current year  
p/y = prior year

Explanations

**DAYS' SALES IN RECEIVABLES INDEX** - This sales variable index measures whether receivables and revenues are in or out of balance in two consecutive reporting periods. **A material increase in the index could indicate a company's receivables are phony.**

**GROSS MARGIN INDEX** - This index is designed to alert users that the risk of earnings manipulation is higher when gross margins drop. **But, if the company is already engaging in attempts to inflate earnings, gross margins will be higher.**

**ASSET QUALITY INDEX** - This asset quality ratio measures the proportion of total assets for which future benefits may be less certain. **An increase in the asset quality index may indicate a company's propensity to capitalize costs.**

**SALES GROWTH INDEX** - Designed to detect if a company is adding fake sales. **An increase in the index reflects a rise in sales, which may or may not be legitimate.** The sales growth index can detect potential fraud only when sales have increased.

**TOTAL ACCRUALS TO TOTAL ASSETS INDEX** - An increase in accruals from one period to the next may indicate management is attempting to manipulate earnings through its discretionary authority over accrual policy. **The presence of higher accruals and a corresponding decrease in cash often can be an attempt by management to internally finance its losses.**

**CASH FLOW/ INCOME INDEX** - Over time, this ratio should hover around zero (or be slightly negative because of depreciation) with some positive periods and some negative periods. Consistent positive numbers in this ratio can often spell trouble and show financial statement fraud that increases reported income, but not cash flows, is taking place

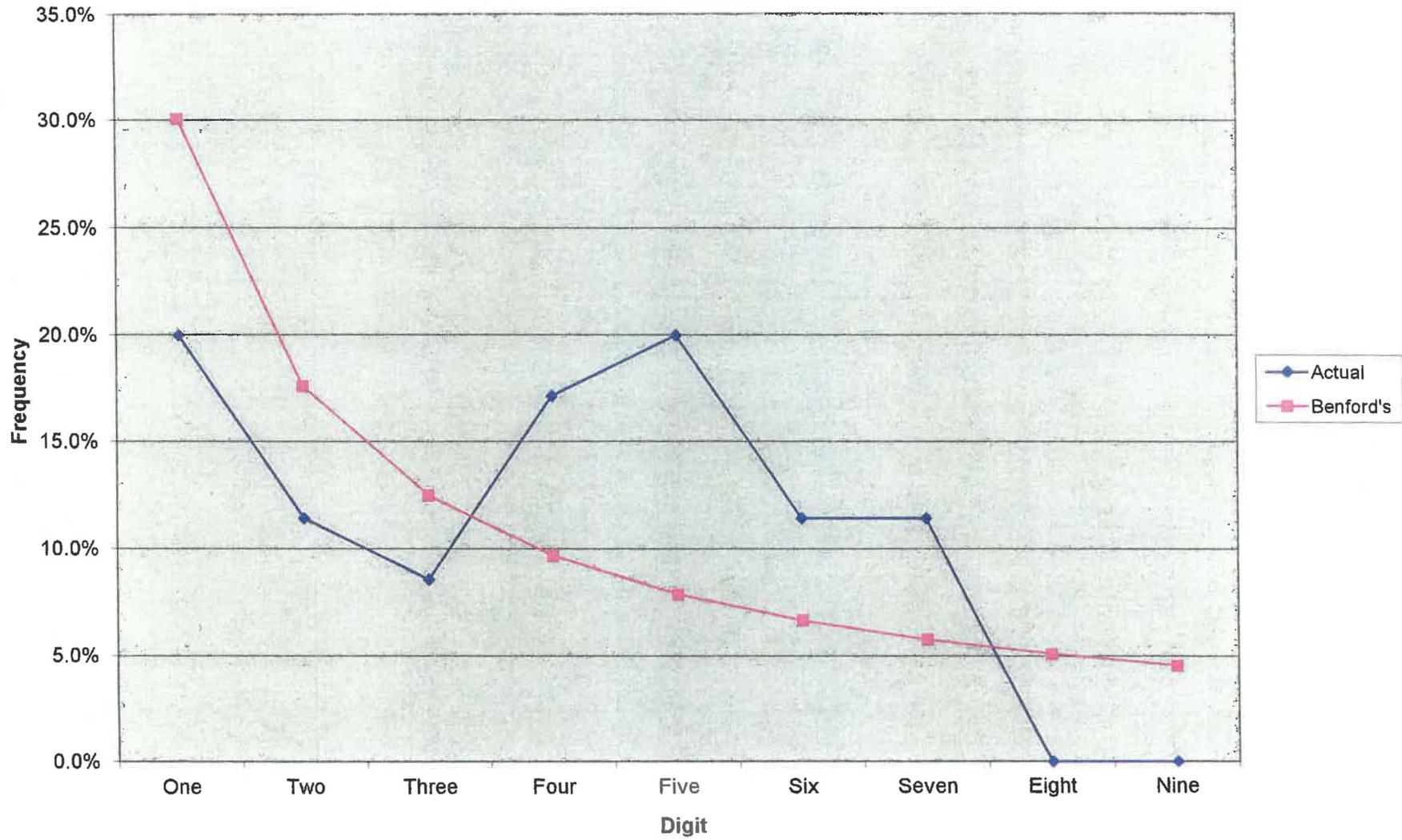
	2001	2002	2003	2004	2005
Accts Rec - Trade	551,208	446,952	525,459	732,032	457,139
Sales	10,127,931	8,559,914	7,889,133	8,359,324	8,296,858
Cost of Sales	9,227,132	5,822,067	5,206,825	5,681,120	5,646,088
Current Assets	1,389,835	1,111,825	1,204,981	1,504,984	1,111,664
Fixed Assets, net	1,481,104	1,204,740	984,483	796,742	817,296
Total Assets	2,871,664	2,317,290	2,214,178	2,346,358	2,002,280
Current Liabilities	632,112	679,780	970,758	1,253,761	791,544
Working Capital (CA-CL)	757,723	432,045	234,223	251,223	320,120
Cash	4,263	10,852	3,058	757	780
Current Taxes Payable	3,657	3,048	2,598	2,203	1,531
Depreciation/Amortization	357,065	346,821	325,966	313,838	247,950
Income from Operations	(254,443)	(254,791)	(384,975)	(349,167)	(318,288)
Cash Flow from Operations	N/A	493,006	(81,304)	22,607	105,262



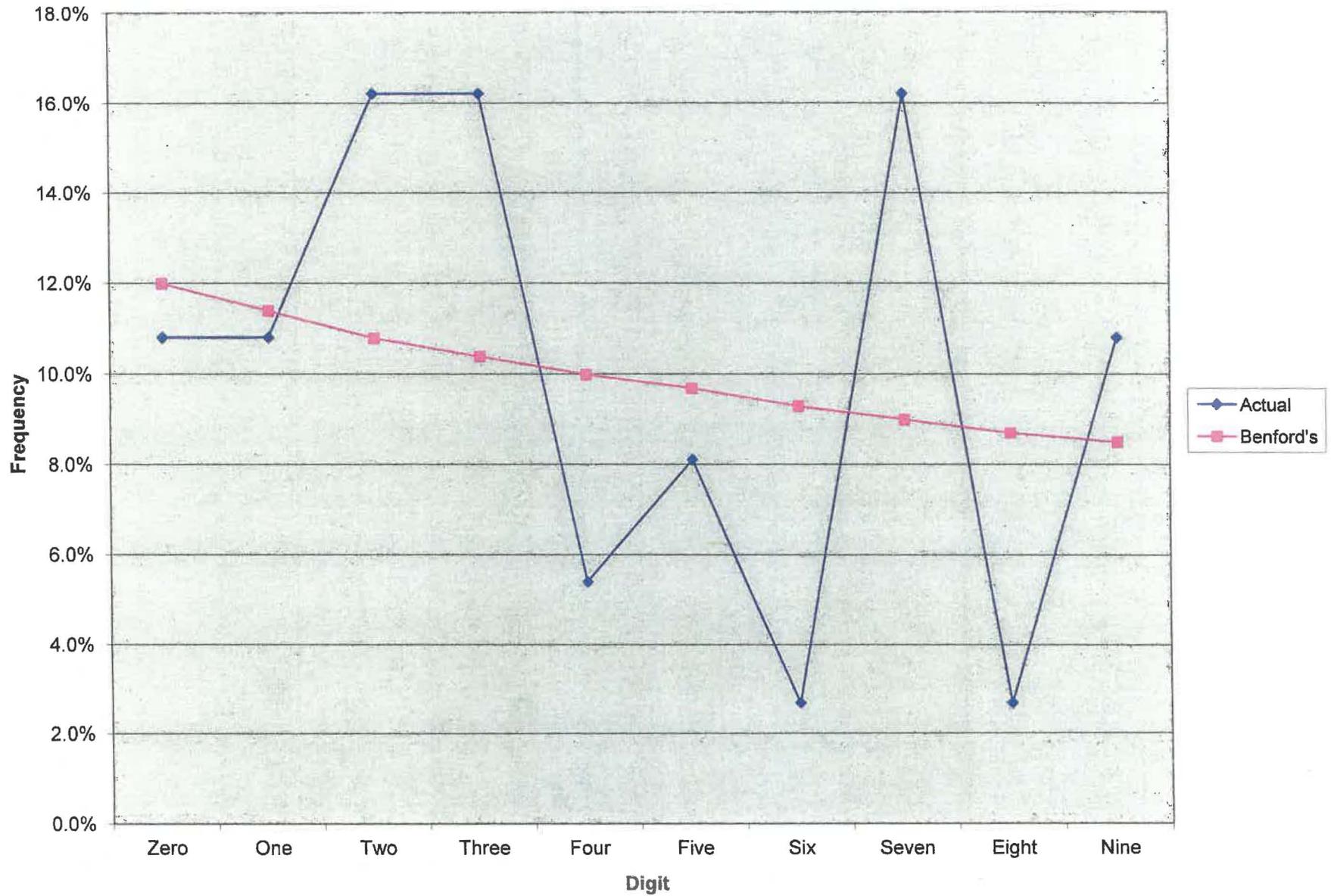
FIRST FRAUDSTERS, INC.  
05 Outside Numbers

	Data	1st Char	2nd Char	First Digit		Actual Percentage	Benfords L
Assets	780	7	8	One	7	17.9%	30.1%
	457139	4	5	Two	6	15.4%	17.6%
	1210	1	2	Three	4	10.3%	12.5%
	560251	5	6	Four	4	10.3%	9.7%
	3644	3	6	Five	5	12.8%	7.9%
	68807	6	8	Six	4	10.3%	6.7%
	19833	1	9	Seven	6	15.4%	5.8%
	17233	1	7	Eight	3	7.7%	5.1%
	6405346	6	4	Nine	0	0.0%	4.6%
	5605283	5	6				
	725	7	2				
	72595	7	2				
Liabilities				Second Digit		Actual Percentage	Benfords L
				Zero	2	5.1%	12.0%
				One	1	2.6%	11.4%
	275499	2	7	Two	4	10.3%	10.8%
	24535	2	4	Three	4	10.3%	10.4%
	7515	7	5	Four	4	10.3%	10.0%
	1531	1	5	Five	5	12.8%	9.7%
	747	7	4	Six	9	23.1%	9.3%
	454000	4	5	Seven	6	15.4%	9.0%
	27717	2	7	Eight	3	7.7%	8.7%
	345004	3	4	Nine	1	2.6%	8.5%
	131922	1	3				
	609737	6	0				
	27717	2	7				
	3320	3	3				
	53000	5	3				
	219381	2	1				
	76278	7	6				
47633	4	7					
Rev & Exp	8296858	8	2				
	5646088	5	6				
	1377200	1	3				
	368384	3	6				
	567179	5	6				
	656295	6	5				
	8006	8	0				
	87713	8	7				
	167825	1	6				
	466	4	6				
	28688	2	8				

### First Fraudsters, Inc. Benford's Law First Digit Test--EXHIBIT 6



### First Fraudsters, Inc. Benford's Law Second Digit Test--EXHIBIT 7





## **THE ACCOUNTANT AS EXPERT WITNESS**

CHARLES L. KERN, BS/MBA/CPA/CFA/CFF/CVA/ABV/AEP/FCPA

### I. THE ROLE OF THE ACCOUNTING EXPERT

A. Consultant versus expert

B. Consultant is there as an advocate

C. Expert is there as an educator with an opinion to express

1. The expert is to educate the court

2. The judge

3. The jury

4. The attorney the expert is working with

5. The attorney representing the other side

D. Educating the attorney you are working with:

1. Try to teach all you know about the narrow specific area(s) being addressed

2. Distinguish between the definite, the plausible, the probable, and the possible

3. Give instruction about the accounting issues/flaws in opposing opinion and views

4. Give anticipated opposition responses to arguments to be made

5. Elaborate as to rebuttals thereto

E. Soft skills

1. Public speaking

2. Teaching

3. Writing

F. Other areas of study

1. Psychology
2. Industrial sociology
3. Managerial accounting

II. MEANING OF FORENSIC ACCOUNTING AND ACCOUNTANT

- A. Forensic accounting: Drawing reasonable accounting conclusions from incomplete accounting information.
- B. Forensic accountant: Detects and interprets evidence of both normal (non-fraudulent) and abnormal (fraudulent) phenomena in the books and records of an accounting system and the resultant effect upon the accounts and presentation thereof.
- C. Credentials:
1. Business valuation—CVA, ABV, ASA, CBA
    - a) Certified valuation analyst
    - b) Accredited business valuator
    - c) Accredited senior appraiser
    - d) Certified business appraiser
  2. Forensic accounting—CFE, CFF, CFFA, FCPA
    - a) Certified forensic examiner
    - b) Certification in financial forensics
    - c) Certified forensic financial analyst
    - d) Forensic CPA
- D. Forensic accountant vis a vis the attorney—attorney is the “quarterback”

III. FEDERAL GUIDELINES ON EXPERT WITNESS ON TESTIMONY AND REPORTS

- A. (FRE) Rule 702. Testimony by Experts: “If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill,

experience, training, or education, may testify thereto in the form of an opinion or otherwise, if (1) the testimony is based upon sufficient facts or data, (2) the testimony is the product of reliable principles and methods, and (3) the witness has applied the principles and methods reliably to the facts in the case.”

- B. FRCP Rule 26(a)(2)(B). (B) Written Report. Unless otherwise stipulated or ordered by the court, this disclosure must be accompanied by a written report- prepared and signed by the witness- if the witness is one retained or specially employed to provide expert testimony in the case or one whose duties as the party’s employee regularly involve giving expert testimony. The report must contain:
1. A complete statement of all opinions the witness will express and the basis and reasons for them
  2. The data or other information considered by the witness in forming them
  3. Any exhibits that will be used to summarize or support them
  4. The witness’s qualifications, including a list of publications authored in the previous 10 years
  5. A list of all other cases in which, during the previous 4 years, the witness testified as an expert at trial or by deposition
  6. A statement of the compensation to be paid for the study and testimony in the case

# Small Business Valuations

QR [quickreadbuzz.com/2019/07/17/forensic-accounting-josh-shilts-small-business-valuations/](https://quickreadbuzz.com/2019/07/17/forensic-accounting-josh-shilts-small-business-valuations/)

National Association of Certified Valuators and Analysts

July 18, 2019

## Using Forensic Accounting

Valuing the small business is how most valuers earn their living. These small businesses pose as much issues to valuation professionals as they do for tax, accounting, and legal professionals by providing these entities with advice. The issues are wide-ranging, and the purpose of this article is not to patronize small business owners; rather, the purpose of this article is to discuss the challenges we in the valuation community face when valuing small businesses and how forensic accounting techniques can help.



### Resources:

[Forensic Accounting Academy](#)

[Forensic Accounting Specialty Webinars](#)

[Forensic Accounting Techniques in Business Appraisals](#)

[Financial Statements—Written Confessions](#)

According to the U.S. Small Business Administration's (SBA) *2018 Small Business Profile*, there are 30.2 million small businesses in the U.S., accounting for 99.9% of U.S. businesses and employing 58.9 million individuals (47.5% of U.S. employees). While the definition of what is a small business

can be argued, what cannot be disagreed is that the U.S. business valuation community deals with “small business” valuations much more widely than public companies. Valuing the small business is how most valuers earn their living. These small businesses pose as much issues to valuation professionals as they do for tax, accounting, and legal professionals by providing these entities with advice. The issues are wide-ranging, and the purpose of this article is not to patronize small business owners; rather, the purpose of this article is to discuss the challenges we in the valuation community face when valuing small businesses and how forensic accounting techniques can help.

How many of you have started a valuation engagement and the only financial statements you receive are the previous years tax returns? How many of those tax returns have discarded Schedule L (balance sheet) information? The point I am trying to make is that valuers are already starting at a disadvantaged place. Many of the valuation engagements we perform require us to put on our forensic accounting and tax advisor hats to unravel the poor books and records to ensure that the “baseline” financial data is accurate. Many small businesses only reporting requirements are for federal tax purposes; thus, there is a heavy emphasis by their preparers to minimize tax liabilities and not to ensure that tax returns (which are NOT financial statements) are complete and accurate. What we are left with is a picture through one viewpoint, which may not be representative of the financial condition of the subject company.

Two common methods used today to determine and allocate value to enterprise and personal goodwill are the Bottoms-up Method and the With-or-Without Method. To correctly apply these methods, an analyst needs to use techniques founded in forensic accounting. The remainder of this article discusses those techniques and their application to the valuation process.

In my opinion, before we look at any financials or speak to management, we need to understand the industry and the market the subject company works in. An understanding of the typical types of revenues, expenses, assets, and liabilities will allow the forensic accounting expert to identify “baseline” data which can be used to identify unusual or unnecessary items. This allows the forensic accountant to put together questions to ask the subject company owner. These questions are one of the tools forensic accountants use during inquiry to uncover unknown or unidentified assets, liabilities, revenues, or expenses.

Another forensic accounting technique is data driven. Vertical and Horizontal analysis is a helpful tool to also understand trends and deviations from historical data. Vertical analysis is the use of common sizing financial statements. These figures can be compared to industry benchmarks or other related companies to understand what, if any, deviations there are. This information can be used in horizontal analysis wherein you review data over a period to identify linear trends. Looking at figures in dollars or as percentages can give a unique insight and perspective for these comparative purposes. It also may identify relations between income statements and balance sheets. For example, it is not uncommon to see many expense line items “disappear”. However, when focusing on the income statement alone, an individual may not identify that, for some reason, the subject company has capitalized these expenses. A second example to the above scenario can find changes in accounting procedures wherein an individual may decide to “hide” or book transactions to an equity account.

The identification of trends, deviations, or other occurrences helps forensic accountants not only piece together items that need further review but assist attorneys in forming questions for deposition or interrogatories. These questions are key to helping you and the attorney unravel some of the mess you are looking at. They also may impact other sections of the matter your working on such as hidden assets in a business that are personal (i.e., divorce) or the improper recognition of expenses that should be capitalized as assets (i.e., lost profits).

Most well-trained accountants can identify the items described above. A forensic accountant is skilled in crafting questions. Knowing that the person being asked the question may not be truthful is always in the mind of a forensic accountant. Thus, it is imperative to develop questions that do not outright seek the answer by alerting the individual of what was found. Let me give a quick example.

John CPA is working with Jane Attorney on a family law case and suspects the husband is hiding personal assets within the business. John identified this by noticing certain expense trends that were not found in prior years and an increase in office expense, but no changes in personnel or anything else operationally. Instead of asking husband directly about these items, John asks, "I see that your net profits have decreased; this must be hard on you meeting personal objectives". This is a subtle change, but what John has done is built a rapport with Husband. He indirectly lets him know he "feels his pain" and begins the process of opening the husband up as opposed to keeping the husband in a defensive position. It is important that during inquiries, valuers do not try to "win the case" with a GOTCHA question; rather, an inviting nature can go a long way. Maybe you do not get a direct answer, but you find out that the general ledger details that were not available suddenly are.

My point is that forensic accountants are trained to play chess. They understand that not every battle is won, but you must give to get.



## **WHERE DID YOU SAY YOU PUT THAT?!**

**By**

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There are many situations where one might ask, "How can I tell what and where a person has placed (or tried to hide) their financial assets?" Some such situations that readily come to mind are:

- Estate settlements
- Marital divorces
- Business divestitures, split ups, spin offs, etc.
- Due diligence for business acquisitions
- Fraud investigations
- IRS investigations and/or negotiations
- Other regulatory investigations and/or negotiations.

The assets might be real or imagined, larger or smaller than we expect. To the person who believes and/or is entitled to a share of the assets, it can be as tough as looking for the proverbial pot of gold at the end of a rainbow. In this article we want to shed a little light on the subject, meaning to give the reader some places to begin the search and a frame of mind to maintain during the search. Specifically, we will be looking at:

1. A sample of such assets (cash or cash equivalents) that you might not immediately think of
2. Some types of financial documents to be looked at
3. Some sources that are new to us out of the generosity of our "high tech" society.

Let's look at some cash/cash equivalents. If another party doesn't want you to notice their cash or cash equivalents (items readily convertible to cash) there are some pretty clever ways and places to put them. For example, a person might intentionally over pay their credit card bills by a significant amount, creating a source for refunds and/or a funding source for purchases. If you send Master Card or Visa \$10,000 more than you owe, they will gladly accept it. Or how about your old buddies the IRS? If you send them \$10,000 or \$20,000 too much, they will be glad to accept it, hold it, and not pay you interest. Later you could get it refunded or use it to pay taxes due in the future. There is another kind of cash equivalent that is a bit more esoteric. There are "income tax loss carryovers". Capital loss carryovers are a good example. They can

be carried forward indefinitely, offsetting the taxes that would be due on capital gains realized in future years. If you had \$66,666 in capital loss carryovers to offset anticipated capital gains, at a capital gain tax rate of 15%, there will be another \$10,000 in your pocket. In another example, if you and/or your business have old operating losses that can be carried forward indefinitely, and future profits are realistically expected, those loss carryovers would constitute cash equivalents.

Now comes the question as to what types of documents might we look at to discover and/or uncover these reserves of cash and cash equivalents. A good place to begin is the bank statement for savings and checking accounts. Look at the individual deposits and identify the nature and source of those deposits. Perhaps the deposits came from other unknown accounts, income sources you might not have been aware of, or gift and inheritance sources. Analyze the income tax returns and/or financial statements of the other party and their business interests. If they show "other income", ask what asset is the source of that income? If the financial statements show liabilities to the owner(s), is the other party in question one of the owners who is owed money? Analyze the loan applications made by the other party. Often such loan applications will require a valuation of business(s) owned by the loan applicant—your "other party". It is unlikely that the valuation will be intentionally understated in these situations. Any other assets pledged as collateral for the loan(s) might also be very revealing and interesting to you.

Now don't we all just love the never ending march of technology? This might be especially true for the technology of communication. Huge segments of our society, including perhaps the party that you think might be hiding cash or cash equivalents, use recent technology like Google, Twitter, Facebook, and LinkedIn to communicate. And as the old television show host Art Linkletter used to exclaim, "People say the darndest things!" Some of those "darndest" things might just reveal cash or cash equivalents. And what "other party" doesn't communicate by email in this day and age. Again, "People say the darndest things".

Another document that can be wonderfully revealing, as to where cash and cash equivalents might be found, is "ye ole passport". Maybe that "other party" enjoys a lot of international travel. Maybe they decided to keep cash and/or cash equivalents in those other countries. Frankly, if one travels a great deal, there are many good non-offensive reasons to keep money in one or more of those countries. Offensive or not, keeping those assets out of your reach might be one of the reasons therefore. It probably isn't easy to get your hands on those assets, but there might be available an equivalent amount of more accessible assets. The question is worth the asking! So let me repeat the question:

**WHERE DID YOU SAY YOU PUT THAT?!**