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The Flags are Up

frighteningly, perhaps with your own firm), we urge that serious attention be given as quickly as possible to the potential that indeed there may be fraud existing or developing. In such a case, the highest level individuals, along with corporate counsel and a fraud oriented forensic accounting team, need to devote their time and attention to the possibilities.

The following are some brief items which should give you and your clients cause for concern. They are not in any particular order.

- The Company is just doing too well – whether it be profit margins, growth, or whatever, it's simply so much better than the industry that it should cause concern. The cliché here is very apt – if it's too good to be true, it's probably not true.
- Disrespect for internal controls. There is a good reason for the existence of internal controls – and that is to protect the assets of a company. By doing so it also protects the employees, with special concern for the upper level employees who are typically held responsible for many functions. When those upper level employees, management, do not respect the internal controls, it may suggest that they have a personal profit motive driving that disrespect. At the very least, even if management is not guilty of anything criminal, it is setting a tone/standard for the company that will make it easier for others to commit fraud.
- Employees involved in the financial controls of the company who never seem to take a vacation. This of course is one of those classics, the bookkeeper or controller or bank officer who never takes a vacation, who is there all day, often arriving early and staying late. Sometimes, these people do that because they are committing fraud, and they cannot allow anyone else to have an opportunity to go through the records in which they are involved and perhaps find them out.
- Excessive complaints from customers. It is indeed a rare and truly phenomenal business that doesn't get customer complaints. However, if those complaints have increased dramatically in the recent past, if they are coming in too frequently and heavily, it may be a sign that there is something criminal going on within the company.
- Frequent bank overdrafts. While some businesses wouldn't know what to do if they actually had money in the bank, there are others that have a track record of maintaining respectable balances, and then all of a sudden run into cash flow problems, and have recurring overdrafts. That is another warning sign of a potential problem – of someone playing a numbers game, perhaps trying to stay one step ahead of the next receipt.
- High level employees, who typically had delegated various functions, are now performing those lower level functions themselves. When management type individuals tend to various job functions that are typically done by subordinates, one possible reason is they are cooking the books and want to keep as few people informed about it as possible.
- High employee turnover, especially in the financial departments. Almost every company has employee turnover, some are used to it at higher levels than others, and some will go through periods of time when it becomes abnormally high. A particular concern is when the turnover is higher than should be expected, and when it affects the financial departments – signs that there may be honest employees who are leaving because they cannot take the games that are going on. Or, the people who are pulling the strings are forcing turnover so that no one is there who really knows what is going on.
- Inadequate separation of duties. This is a classic fraud prevention issue – a separation of what employees do so that no one employee controls too many aspects of a series of functions in a way that would allow that employee to manipulate the numbers. The simple classic example is the bookkeeper, who not only writes the checks and enters them in the journals, but also receives the bank statements and reconciles the accounts.

- Internal reports are never ready when they are supposed to be. If a department (or maybe the whole company) is supposed to issue a report or financial statement by a certain date, and historically that is what has happened (for instance a quarterly report), and now for the past number of periods (i.e. if we are dealing with quarterly reports, let's say for the last three quarters) they are not done on time, and there always seems to be some half-baked reason, beware.
- Emotional highs and lows, major mood swings, from an employee. The reality of committing fraud for most people, is that is causes them to swing back and forth in their attitude, having good times and bad times, with the pressure at times making them testy, or worse. Few of us are truly psychologists, but some basic and simple observations might suggest a problem like fraud. It might also suggest that the person is having severe problems in his/her personal life. In that case, while it may not be fraud, don't overlook that if those problems cause financial issues, the pressures involved with same might push even an otherwise excellent employee into the realm of fraud.
- Lavish spending habits of employees. Sometimes you just know when even someone making hundreds of thousands of dollars a year is spending more than that level of income could possibly support.
- Lots of employee complaints. Recognize that employees, depending on the company and the industry, have a tendency to complain in general – but pervasive complaining is a warning sign for fraud.
- Management is too involved in day-to-day bookkeeping type functions, and at the same time is known to be aggressive. When the upper level is extremely aggressive, such as in meeting goals, they will sometimes overreach to make the numbers come out where they have targeted them to be or where they have promised others they would be.
- Too many photocopies of invoices and/or missing documents. Unfortunately (at least in this sense), the quality of photocopies nowadays, combined with computer print-outs of so many things, is so good, that it is hard to avoid overwhelming quantities of copies – and sometimes you can't even tell if it's a copy. Copies can be manipulated and altered far more easily than originals. In addition, if the auditors or others within a company ask for documents that simply are not there on a somewhat regular basis, that is another warning sign – someone may have removed documents which might show financial wrongdoings.

Remember, the above are warnings; they should bring to your attention the need to delve further into the situation. The existence of any of these does not necessarily means there's fraud. However, ignoring these warning signs will make fraud easier to happen, and when it happens, it will make it bigger.

If The BARSON GROUP can be of assistance to you and your clients, it would be our pleasure to work closely with you to prevent, or detect fraud and to help to recover as much of the theft as possible.

FOCUS ON FUN

Accountants & Humor
– A Sociological Fable

1. Several years ago, before social security numbers were required for claiming a dependant on a tax return, it was not all that unusual for people to claim their pet dogs or cats as dependants to get the extra exemption deduction. There was the case of a taxpayer from Camden, NJ who listed two burros as dependants. He even used their actual names – Happy Jack and Sassafras. This was actually a situation where someone read the return – the names tipped off an IRS auditor that something might be wrong.
2. In determining the fair market value of a bomb site donated by a taxpayer to a museum – it is necessary to determine the value for purposes of calculating his allowable charitable contribution deduction – the Court took into consideration both the appraisal of the taxpayer's expert witness and the fact that there was a cloud on the title of the bomb site. Hopefully for our sakes, it was not a mushroom cloud.

Tax Concerns in Divorce Settlements

In the divorce process assets, and liabilities can be maneuvered between divorcing spouses with no immediate tax consequences. However, the tax issues do not go away, they merely get shifted and often deferred. Areas of concern include:

- Appreciated assets within the company – a company may own real estate or have stock market investments. Especially if it is a C Corporation, it may have a built-in gains tax;
- Tax on the business' value – while a business may be valued at $1 million, its tax basis in the hands of the owner may only be $100,000, leaving a $900,000 gain which is potentially subject to tax;
- Virtually any assets involved in equitable distribution – for instance, a stock portfolio can have gains subject to tax (when sold), or losses, providing a tax benefit (when sold);
- Retirement plan – distributions are taxed as ordinary income (as withdrawn). Tax-free transfer via a QDRO doesn't eliminate the tax, it simply defers it;
- Home sweet home – often overlooked as a tax issue. While the first $500,000 of gain is tax-free, the way real estate values have increased, many houses have more than $500,000 of gain. Worse, once divorced, subject to some exceptions, whoever keeps the house is entitled to only a $250,000 tax-free gain;
- Other real estate – vacation homes or rental property are not eligible for the $250,000/$500,000 free ride. In addition, rental property gets depreciated for tax purposes – leaving more of a taxable gain than many people realize.

To compound all other issues, many of these taxes are arguably hypothetical, and often are not imminent. How are potential or deferred taxes accounted for in the allocation? Tax issues in divorce can be complex, and need to be addressed carefully.

Divorce Taxation: The Basics - our book, 40 pages explaining Divorce Taxation in layman's terms, is available - complimentary copies for the asking. Contact us if you haven't received your copy.

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Forensic Forum

published by the Barson Group

Calendar

Recognition: Kal Barson was recognized as an outstanding speaker for 2005 by the Florida Institute of CPAs.

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March 2006

22 - Morris County Bar – Divorce Taxation (Morristown)

May 2006

18 - ICLE – Divorce Taxation (Atlantic City)

September 2006

12 - CPA Club – Investigative Accounting Process in Litigation – Part II (Saddle Brook)

16 - Family Law Section NJ Bar & NJ Society CPAs – Current Issues in Business Valuation (Iselin)

20 - Institute of Management Accountants – Investigative Accounting Process in Litigation (East Hanover)

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- ***Book - Divorce Taxation: The Basics*** by the Staff of The BARSON GROUP
- ***Article - Investigative Accounting A Force in Matrimonal Practice*** American Journal of Family Law (winter 2006)
- ***Article - Sampling the Goods*** American Journal of Family Law (fall 2006)

Janet Barson & Laura Johnson
(Editorial, Design & Layout)

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The Flags are Up

In the financial world, one of the ongoing major headaches, and one which seems to have become more so over the last several years, is that of fraud. In particular, reference here is to what we will call financial statement fraud. There is of course the humdrum fraud that truly happens every day – for instance, an employee falsifying an invoice or altering a check and thus stealing a few hundred or even thousands of dollars. What is often the far more significant, and from a business owner's and lawyer's point of view, far more important, fraud is the type that results in a substantial distortion of financial statements.

These types of financial shenanigans have the potential to wreak substantial damages to a wide range of businesses and individuals. We could of course look at some of the more publicized examples, such as Enron and WorldCom, and how billions were lost and thousands of people adversely impacted. However, for most of us, what we are really concerned about in our personal and business lives are those situations which, while conceptually similar to Enron or WorldCom, are in the hundreds of thousands or few millions of dollars. While they affect us dearly and make a big difference, they just don't get the media play that the billion dollar, high publicity situations get.

We at The BARSON GROUP, have assisted a number of clients in both uncovering and preventing fraud. This is an area where a reasonable amount of preventive attention can and does get rewarded with less exposure to fraud, fewer frauds, and overall less expensive frauds.

This article is intended to provide just a brief sense, an overview, of some of the warning signs that suggest there may be fraud in the making. None of these by themselves mean there is fraud, and even several or perhaps even all of these warning signs wouldn't in the aggregate mean that there is fraud. But the reality, based on much experience, is that the more of these warning signs that exist, the more likely there is fraud, and certainly the more cautious one needs to be. If you recognize a number of these indicators as on-point with any of your clients (and

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Business Valuation: The Basics - our new book, 50 pages explaining Business Valuation in layman's terms, is available - complimentary copies for the asking. Contact us if you haven't received your copy.

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