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Forensic Accountants Society of North America

## FASNA FORUM

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# The Forensic Accountant: First on the Scene

by Mike Pivoz, CPA, JD, Mellen, Smith & Pivoz PLC, FASNA Member

The flames were barely out when the claims adjuster called me in for help after a large fire. But why was he calling me, a forensic accountant? What kind of assistance was he expecting me to provide? After all, I couldn't help him determine how the fire started, how long the business would be closed, if the inventory was saleable or if the equipment was still useable. These were the jobs of the Cause and Origin expert, the engineering expert and a number of other experts that would have been called to the scene.

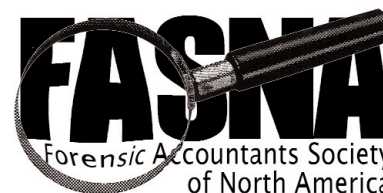
So why did the adjuster call me? As a forensic accountant, I could help with several aspects of the claim. First, the business was a retail establishment and had lost inventory in the fire. When the insured submitted his proof of loss, he would claim a certain value for this lost inventory. Forensic accountants determine whether the books and records of the insured support the claimed loss.

Forensic accountants can determine the validity of a lost inventory claim in a number of ways. There may have been a recent physical inventory count taken at the business. If I felt these numbers were accurate, I could roll the inventory count forward, adjusting for sales and new inventory purchases to the date of loss, then test these numbers using invoices from vendors.

However, many businesses do not maintain physical inventory records. In these cases, I review records the insured uses to prepare his proof of loss and test them for accuracy and determine whether the business's physical space would be able to hold the amount of inventory claimed. Alternate procedures, from contacting vendors to determining inventory purchases to reviewing tax records to determine what might have been sold from the inventory, might be used as well. The level of assistance I would give to the adjuster depends, in large part, on the quality of records the business makes available.



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## CASEWORK EXPERIENCE

FASNA member casework includes, but is not limited to, cases involving:

- Inventory/property loss
- Employee dishonesty
- Business income loss
- Personal injury or wrongful death claims
- Truth in lending/truth in leasing
- Post judgement matters/calculations
- Loss of income/earnings
- Divorce and fidelity claims
- Business valuation
- Expert testimony
- Fraud

## INDUSTRY EXPERIENCE

FASNA member experience includes, but is not limited to cases involving:

- Auto dealerships and transportation
- Colleges and universities
- Construction, contracting, and engineering
- Financial/money management, trust, and estate
- Healthcare
- State and Indian tribal government
- Insurance claims
- Manufacturing
- Real estate
- Restaurant and hotel industries
- Retailing/wholesale

## First on the Scene...continued from cover

Another area where I can assist the adjuster is financial motive. Forensic accountants are specially trained to look for and identify unusual financial transactions that may indicate a financial motive for a loss. Ultimately, fraud units and law enforcement would get involved in these cases, but many times it is the forensic accountant that actually discovers a problem with a claimed loss.

If experts determine the fire started under suspicious circumstances, I may also have to determine if the business owner stood to benefit financially from the fire. Financial motives could include continuing losses generated by the business, lawsuits against the business or its owner or pressure from the bank to pay down lines or credit or catch up on delinquent installment loan payments. When investigating financial motives, I focus on the financial records of the business, including tax returns and bank statements. In addition, I review public records to check for litigation involving the business or recent lien filings by government agencies or others.

A third, and perhaps most significant area where I can assist the adjuster is in the review of the claimed business interruption loss. Business interruption coverage exists to put the insured in the same position in which they would have been, but for the loss. Though this is a relatively simple objective, the determination of this is anything but simple. This is because the calculation of the loss is based on a prediction of the future.

Most businesses aren't sophisticated enough to prepare detailed budgets and forecasts for the future, so there is generally no preexisting record of what the business is anticipating in the short-term future. Therefore, when determining business interruption loss, management is usually projecting future results after the loss has occurred. In these cases, there is an obvious benefit to being extremely optimistic in these projections.

***“Forensic accountants are specially trained to look for and identify unusual financial transactions that may indicate a financial motive for a loss.”***

In these situations, I analyze projected income in light of all relevant factors, including history and review of the current situation relating to the business. History tells me where the business has been. The longer the history, the more trends and patterns that can be identified. The current situation is important as it relates to the industry, competition and the economy, as all of these factors impact whether historical trends will continue into the projection period.

I then synthesize all of this information in the process of reviewing the business interruption claim calculation. In looking at the financial statements of the insured, if they exist, I factor in any adjustments made to the business's income that are the result of generally accepted accounting principles, rather than actual business activity. In the end, I provide the adjuster with an analysis of the claim that the adjuster can rely upon.

Just like the experts who determine the cause of the fire, when the business can open and what can be done with inventory and equipment, forensic accountants are vital experts to be called as soon as possible in a situation such as this. By determining the value of lost inventory, whether the insured had financial motives and what the interruption of business will cost the insured, forensic accountants can help adjusters ensure claims are as accurate as possible.

# Using the Clues to Solve a Business Mystery

by Mike Pivoz, CPA, JD, Mellen, Smith & Pivoz PLC, FASNA Member

**“It was a dark and stormy night. The patron thought he heard a gunshot, but he couldn't be sure; at least, not until the body came crashing through the door.”**

Unlike in the world of fiction, not all mysteries begin this dramatically. Sometimes they start when a business owner gets a call from his banker telling him that his account is overdrawn or when he notices his bookkeeper suddenly driving to work in an expensive new sports car.

The mystery novel is designed to entertain us, while the business mystery threatens to bankrupt us. However, there are some similarities between the two. The mystery writer uses his skilled pen to lead us through a series of facts and clues, sometimes using deception to keep us off the trail of the killer, but in the end, as we review the information provided, the conclusion becomes obvious. Similarly, when employees try to perpetrate fraud, there are facts, clues and other information that should raise our suspicions.

The necessary information to solve these mysteries lies in an appropriately designed accounting/bookkeeping system. Cash receipts and revenue don't just disappear; there will be a trail left in the books and records that show just how cash left a bank account. Accounts receivable statements won't agree with what your customer feels is owed. Expense accounts will be unusually large. Inventory write-downs will be of a different magnitude than what has occurred in the past. This information will allow business owners to stop employee fraud, but they have to look for the clues.

Unfortunately, many business owners overlook these clues. Some are too busy running their business to have the time to personally review records. Others have no background in finance and accounting

and rely on others to review records for them. In many instances, these business owners don't hire outside accountants to do anything more than prepare a year-end tax return.

More vigilance is needed now than ever before as more and more businesses become the victims of fraud. Having a forensic accountant review your records at least once a year may cost a bit more than what a business owner would like, but potential benefits could outweigh the costs. First, forensic accountants may find instances of fraud on a more timely basis so the perpetrator can be caught and the business can be made whole. In addition, they could stop fraudulent activity before it happens, deterring employees from committing fraud when they become aware that the business is using a forensic accountant.

Although forensic accountants are strong deterrents to fraudulent activity, the first line of defense against fraud is still the business owner, who needs to establish procedures that make fraud more difficult. In accounting lingo, this is referred to as internal control, and one of the basic concepts of internal control is the segregation of duties. When duties are segregated, there must be a conspiracy among employees to perpetrate fraud. The more people involved, the less likely a conspiracy is to succeed, and this is why accountants discourage systems where only one person opens the mail, prepares bank deposits, takes deposits to the bank, records activity in accounting records or prepares the bank reconciliation. It would be a recipe for employee theft.

However, accountants understand that in small businesses there may not be enough

employees to properly segregate these duties. In that case, the business owner has to take upon himself a supervisory role, reviewing activity on a regular basis. In order to have a deterrent effect, this review must be obvious to employees.

Business owners must also use their eyes and ears to monitor what goes on in their business. Pay attention to situations where an employee seems to be living beyond their means. Listen to employees as they complain about heavy financial burdens with which they suddenly find themselves confronted. Maintain enough regular contact with employees that they would find it difficult to hide a substance abuse problem. Have a sympathetic ear for employees who are going through marital difficulties.

These are all situations where an employee's perceived need for extra funds may outweigh their normal moral outrage at stealing. Many rationalize it as "borrowing," but this would probably be a "loan" that would never be repaid. If the business owner becomes suspicious of an employee, he should contact a forensic accountant to do a clandestine analysis.

A skilled mystery writer weaves a tale for us that keeps readers glued to their seats, anticipating the end of the story, using the clues provided to solve the mystery before the writer reveals the resolution. An employee who steals from a business also weaves a tale, leaving clues behind. A business owner must be attuned to the information laid out before him and sometimes call upon forensic accountants to help him unravel this information. If not, fraud might not be discovered until it is too late.