



Certified Public Accountants  
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# Litigation Consulting

## Update

Forensic Accounting - Fraud - Business Valuation

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## June 2013

### *Spotting Fraud*

The shock of realization when a victim recognizes that a trusted employee - and even a friend - has stolen from them ranges from sad to tragic. It is a very personal feeling of betrayal and violation. It strikes fear in some, grief in others, and anger in most. It is almost always accompanied by a sense that "I should have known this was going on." The evidence of theft sheds a very bright light on the rear-view mirror. Patterns and circumstances take on a clarity that contemporaneous experience either hid or obscured. Sometimes the clarity was there but for a variety of reasons it was ignored.

#### **Years of fraud**

Investigations have presented some simple, some would say obvious, warnings that if heeded would prevent or quickly expose fraud.

- **Know your employee.** In one case the victim business owner recounted that he knew the prior employer of the employee-bookkeeper really well. He was aware that the bookkeeper had left the prior employer on less-than-positive terms but figured it was none of his business and hired the bookkeeper anyway because of knowledge of the industry. After the embezzlement was discovered a phone call to the prior employer/friend revealed that the bookkeeper was stealing from the current victim to pay off a judgment obtained by the prior employer to recover embezzled funds.
- **Embezzlers tend to be repeat offenders.** This is an obvious follow-up to the prior point. A simple background check is not expensive, easy to do, and in this case would have prevented a really bad hiring decision. It would have confirmed the ill-at-ease feeling of the employer at the time of hiring.
- **Open your own mail.** Let the bookkeeper do the bookkeeping. You cannot abdicate other important (and seemingly unimportant) functions because the clerk is always around and does the job well. Vendor communications, bank statements, and bills from vendors and suppliers are important sources of information. One person having access to all of that makes fraud that much easier.
- **Separate functions and duties.** Many small business owners are so busy that they tend to overlook common sense when assigning work. In many cases, the employee was given the responsibility for answering the phones, opening all the mail, writing checks, making deposits, preparing invoices, reconciling the bank statements, and preparing the financial reporting provided to the business owner and the outside tax preparer. Strategically reassigning even one of those functions would have greatly reduced the opportunity and longevity of the fraud.
- **Don't accept bad answers to good questions.** When the forensic accountant arrived on-scene in one case, the business owner requested a report showing payments to all vendors. The request was preceded with a long list of qualifications by the fraud victim recognizing that it was "difficult" to put such a report together, would "take a long time," and would not be precisely correct. The accountant produced a complete and accurate vendor payment report in about 90 seconds. The business owner was shocked - and the point was made. His bookkeeper, for a long time, had prevented him from seeing the very report that exposed the whole scheme. He had been given every reason in the book why the report couldn't be produced. He learned too late that it was available at the push of a button.
- **Force vacations.** In almost every case another set of eyes on the accounting records would have exposed everything.
- **Follow your instinct.** If the lifestyle of the employee exceeds what you know about the legitimate compensation there is good reason to look harder. If you have a bad feeling when hiring an

employee (see above), don't! If the bookkeeper can't produce simple reports from "the books" they are keeping there is a problem. If you feel like you are working for the bookkeeper rather than them working for you, something is wrong. If it feels like the business is doing better than ever but there isn't any cash there is good reason to find a reasonable explanation.

All of the above rules are separate points of recognition by the business owner when they realize they are a victim of that trusted employee - "I knew something wasn't right. I should have known this was happening." That kind of recognition is never good after-the-fact.

## ***What We Can Learn from a Fraud Investigation***

When the members of the Board of Directors of a large non-profit suspected embezzlement of company funds, they needed help. We met with them and heard about what was, to the board members, the strange pattern of events that had led to their suspicions.

During the meeting the CEO resigned and, as it turned out, the seemingly random facts and "strange" events all fit a classic profile of fraud. Somewhat typically, the board wanted to believe it was simply a misunderstanding, incompetence or laziness.

The Investigation Plan: We proposed a multi-stage engagement ... (*click here for complete article in [HTML](#) or [PDF](#) formats*).

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**Speeches:**

## ***Upcoming Speaking Engagements for Chris Hamilton***

On June 25th, Chris Hamilton will provide a presentation for the **Orange County Superior Court judges** on *"Unraveling the Mystery of Financial Experts"*.

In July, Chris will speak on the topic of *"What CPA's Need to Know About Business Valuation"* to the **CalCPA Channel Counties Chapter "Conejo Valley Discussion Group"**.

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**Clients know us for results. Opposing counsel know [Arxis](#) for wishing they had hired us.**