

The Trust Hazard

Do you know what the most common denominator of devastating fraud is?

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A busy week was interrupted by a phone call from a person who was cold calling forensic accounting firms that might be able to help with a fraud examination. After a brief telephone interview and an e-mail containing a résumé, arrangements were made for a meeting later that same afternoon. The meeting was between the senior management of the firm (an international manufacturing business), the shareholders and corporate counsel. After introductions, the management group began to describe the circumstances leading to their initial phone call.

Case History

For several years the company's CFO was a trusted and reliable member of the management team. In fact, he had established himself as the most reliable resource in the firm and was viewed by management, owners and employees as the de facto leader of the company. As such, he was completely trusted and never gave any reason to question that trust — until recently. They proceeded to describe a pattern of behavior that started as strange, progressed to bizarre and then to simply unacceptable. In the midst of this behavior, there were increasing questions about his ability to do his job and nagging concerns about why the business was so cash starved. After a few questions it became obvious that the nature of this engagement was not primarily concerned with the question of whether fraud had taken place but rather how much had been stolen. This proved to be true.

The relationship with the CFO reflected the culture of the firm. He started out as the company's outside CPA who was retained to prepare annual financial statements, corporate tax returns and individual income tax returns for the owners and key members of management. Eventually he was asked to serve on the board of directors for the company and then to join management. He was instrumental in turning around the company at one point and was credited with putting it back on the right track.

Red Flags

After several years in management, there were complaints of sexual harassment against the CFO. The company was sued by one of the members of the accounting staff — and then sued by another employee with claims of sexual harassment. The increased scrutiny of the CFO as a result of the high-profile extra-marital affairs and lawsuits began to expose other problems including an increasingly eccentric personality and isolation from the rest of the employees and management.

The CFO used to come to the office early, close the door and not come out of his office until well after everyone else had left for the day. It was assumed that he was simply working harder than ever. This was betrayed by the facts that financial reporting was later every month and accuracy was increasingly questioned. Owners and senior management found it difficult to get financial information including monthly financial statements, cash reports, accounts receivable aging reports, etc. The outside accounting firm and the bank found it difficult to get the information they needed. With the CFO assuming all accounting functions, the accounting staff had less and less to do, ultimately bottlenecking all information at the CFO's office. The crisis point came when there was "no cash" and the CFO was unable to answer why there was no cash.

Mismanagement and Appropriation

It was at this point that a forensic accountant was called in to meet with management and the owners. A fraud examination commenced immediately while the CFO was placed on paid leave. What the outside examiners found was astounding in two aspects:

- There were absolutely no internal controls; and
- The exposure to the company was vast and while embezzlement had taken place, it was nowhere near what it could have been.

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The Trust Hazard (*continued*)

The company had divisions in several countries located on all five continents of the world. As such, enormous amounts of money were moved via wire transfer on a daily basis. The CFO had complete control and sole knowledge of both sides of the transfers. He had the authority to make the transfers and record the transfers. There were no reconciliations done nor was reporting done to anyone else in the organization. All confirmations from the remote offices came to the company via the CFO's e-mail. The exposure in just this area amounted to millions of dollars.

Additionally, the CFO initiated all disbursements, signed checks, received and reconciled the bank statement and recorded the transactions in the general ledger. Deposits were handled by an accounts receivable department and all deposit records provided to the CFO. All payroll and HR functions were under the control and authority of the CFO as were purchasing, receiving and all subsidiary and divisional accounting.

Final Meltdown

While the CFO truly had the keys to the vault and could have perpetrated a fraud of breathtaking proportions he did not do that. He was on his way up that ramp, but was interrupted by the suspicions of the rest of the management team. He began to steal on a small scale. His expense reports (that he approved for payment) began to include his monthly rent, household expenses, travel and dates with employees (who later sued the company). He also began to charge personal expenses on the company credit cards (that he approved for payment and recorded in the accounting records as business deductions). Finally, his online gambling habit that was previously unknown to anyone in the company was being financed by the company at increasing rates. It was determined that the eccentric behavior of coming in early and leaving late in a closed office was not to accommodate his attempt to stay up with the accounting load. He was in his office gambling for eight to 14 hours at a time.

Conclusion

While this is a sad story, it is anything but unusual. Most fraud is committed by trusted employees who find a way to exploit that trust — or they take advantage of the opportunities in front of them. The most basic elements of internal control were suppressed because of the long personal relationship with the CFO and the tremendous trust that came with years of faithful and competent work. However, when the personal life of the CFO began to unravel, there were no systems in place to prevent or quickly expose the embezzlement.

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