Do you suspect that someone has hidden assets? Do you need to unravel a complex business structure or a complicated series of business transactions? If so you may need the services of a forensic accountant.

Unravelling skullduggery and 'creative accounting'

Forensic accountants can be called upon to assist in many areas such as tracing assets and unravelling highly complicated and deceitful manipulations by business operators and advisers. As Stephen McMahon and John Worth of McMahon Worth Forensic Accountants show in the following case study, investigating and solving complex problems for a forensic accountant can require the application of a combination of accounting and detective skills.

A bank engaged McMahon Worth Forensic Accountants to trace several million dollars that the bank had advanced to a group of companies just a few months before the group collapsed. The group had run overseas operations in countries that included South America, and the bank was one of a number of institutions to have provided loans to the group.

The bank wanted to know whether its money had been shifted to South America — where the group company directors would soon be heading bank staff were thinking. Although the group had operated several accounts, there was little co-operation between the in-dividual institutions — each tried to protect its own interests — and so the bank had no idea where its money had finished up.

To make matters more complicated, the liquidator appointed over the group had been unable to find any key accounting records for the holding company that controlled the group — there were no cashbooks, general ledger or audit trails to be found. Although much time had been spent searching and documenting what records there were, no one had any idea of what had gone on. In the basement of a deserted Sydney CBD office block, hundreds of boxes of documents detailed a decade or so of wheeling and dealing. Other than the accounting records of the group's subsidiary companies, however, there were no records showing details of what had been happening in the main game. In short, there was now a huge financial black hole.

The brief was outlined, we obtained access to the building and the assignment was under way. ▷

The hunt begins

While the catalogue of documents produced by the liquidator was probably accurate as far as titles went, as often happens, the real significance of something is overlooked. The assignment required us to literally get our hands dirty by going through the boxes of documents. We spent considerable time without finding anything that looked remotely useful.

During the investigation, we located an archive box entitled 'Computer Manuals and Software Disks' containing, not surprisingly, a few manuals and hundreds of computer disks. The disks were not labelled and nothing else gave the slightest clue as to what was recorded on them.

We began examining the disks. An initial search of the directory (a list of files on the disk) showed a number of Lotus 123 spreadsheet files. The file names all had the same structure, but since they were eight characters long and cryptic they meant next to nothing to begin with. Fifty disks later, we were no closer to solving the mystery of the spreadsheet files with a seemingly indecipherable system in their names.

We copied the disks onto a working set of disks and opened the files. Each one contained the transactions for a particular bank account during a specific month. The file names now made sense and their structure indicated the bank where an account was held, the currency (US or Australian dollars) and the month and year recorded — potentially, a full cashbook for as far back as the disks went.

Whoever cleaned out the printed records either did not know the disks existed or did not understand the implications of the information recorded on them. While recreating a full cashbook involves only some simple accounting in most situations, the disks were potential gold on this assignment because the information would allow us to get a grip on where the money might have been shifted.

There was still a lot of work ahead — the group of companies was substantial, with a turnover in excess of A$100m per annum, and there were 10 bank accounts through which money flowed. But at least here was something with which to work.

We sorted the files by bank account, opened each file and combined the data into a comprehensive listing of transactions for each account. The totals matched the published accounts given to the banks. For a forensic accountant, this was significant — the information had passed the first test of accuracy. The next step was to examine the myriad of data held within.

It did not take long to work out where the several million dollars had gone. After being shifted through several accounts with different banks, the money had finally gone to pay out one of the other institutions. No money, at least according to the reconstructed cashbooks, had been sent to South America in the last 18 months. We reported these findings and within a few weeks we were re-hired to examine ways in which the directors had benefitted —–from petty cash up. Justice was demanded by the bank that had lent the money used to pay off one of the other institutions.

A picture begins to emerge

To get a feel for how the group had operated, we decided to examine audited financial statements and an overview of the group's progress during the last decade or so. The holding company had A$10m of capital — not exactly a $2 company! — and had reported profits every year of its existence; so how had it all collapsed in such a short space of time?

The first surprise was the A$10m. In fact, there was only about A$10,000 of seed capital. The way the rest had arisen involved some serious creativity. The directors had routinely revalued assets — always upward — and then distributed the accounting reserve created as bonus shares. A simple analysis also showed the company's trading had in fact rarely been profitable — it was the profits generated from trading in foreign currency that had saved it from year to year.

These guys were good. You've got to be to juggle that scenario, keep several leading local and overseas banks lending to you and keep the auditors at bay. But this information still did not prove anything; it merely gave us a feel for how things had been done. So, it was back to the basement.

There was no big picture evident in the records so far gathered. Even with the reconstructed cashbook, which showed how money had moved in and out of the group for the last 18 months of its life, without a general ledger or an audit trail it was going to be a long haul. It was difficult to decide where to concentrate the investigation and so we examined more closely the records of some of the subsidiary companies to try and get some direction.

Striking gold

One day, while looking for a coffee cup, we discovered a door leading into a small partitioned room. The serial connectors on the wall and in one corner the broken, old acoustic hood for a printer suggested this had once been the printer room for the computer system. In a cupboard was a pile of computer and printer manuals, while underneath them were some full computer-printout binders.

The first few binders contained listings of the computer code that had once driven the company's systems. Opening the next few binders, however, was like striking gold: they contained a complete general ledger for the last 18 months of the holding company's life. Here at last was a potentially complete trail to follow. Without a general journal to provide a narrative explanation of the journal entries, working out the aspects of each entry and the effect of those entries on financial statements would be a daunting task.

After digesting the general ledger, we re-examined the records of the subsidiary companies. The payment records of the group's investment division revealed that on one day, about 10 months before liquidation, a sequence of cheques, all for just a few thousand dollars, had been drawn. This was unusual. All the payments turned out to be investment redemptions made by different people who had invested with the group yet according to the investment register, they all lived at the same address. It did not take long to find out that the people were all residents of a nursing home. But what was the connection between the nursing home and this massive group? Why, after regularly receiving their interest payment for several years, did all these old people redeem their investment on the same day?

The mystery of the nursing home

A call to the home located a helpful nurse who had been there for many years and, it appeared, was something of a confidante to the residents. Apparently all those people had been happy with their investments, but then suddenly, without any notice, they received all their money back. Apparently they got involved in the first place because the grandson of one of the old ladies owned a large company that paid good interest on deposits and the grandmother had happily shared this bit of good luck with some of her companions. Her grandson, as it turned out, was one of the directors of the group.

One day, while looking for a coffee cup, we discovered a door leading into a small partitioned room ...

There are many potential explanations of course. One is that things were going badly and this particular director could not leave his grandmother in the lurch or embarrass her in the close-knit community in which she lived. But if it is true that the directors suspected impending insolvency 10 months before the collapse, what else had they done in the intervening period?

The last 10 months became the focus of the investigation, and in particular, the directors' loan accounts. Each director had gone from owing several million dollars at the start of the period to owing nothing a month or two before the collapse. A search of the now recreated computerised cashbooks revealed that the loans had not been repaid with cash — the 'repayments' were all journal entries.

'Creative accounting'

How the 'repayments' came about is a story in itself. A few years before, the holding company had loaned money to the investment company, which had in turn loaned the money to a property development company that was not directly part of the group. The property developer, however, was owned by the directors. The developer purchased and renovated a Sydney CBD office building and the group then purchased it for several million dollars about nine months before the collapse.

It was a rising property market and the price was not really tested until it was resold within the year, for substantially less than what the group had paid. The directors gave themselves an introduction fee for spotting this 'once in a lifetime' opportunity, and 'giving' it to one of their other related companies. This introduction fee was not paid in cash, but went against their loan accounts. Each director now owed the group about half a million dollars less.

A second transaction was even more convoluted. It started with writing down to A$1 a loan of A$1m owed to the holding company by one of its subsidiaries. The loan was then sold to another company outside the group (controlled by one of the 1980s high fliers who landed in gaol) and revalued back up to nearly A$1m. Then began a series of share issues, revaluations and distributions across another three entities, culminating in a benefit owing to the directors.

That took care of the remainder of their loan accounts: an A$1m loan that is only worth A$1 — which in the hands of someone else is worth A$1m, which then generates a sequence of debts and distributions, which eventually arrives back at the company that owned the debt in the first place — takes care of another A$1m owed to it by its company directors.

Conclusion

Without a thorough investigation by forensic accountants, the bank and its lawyers would probably have been left wondering whether their funds had been covertly shifted to South America, while the liquidator would have remained frustrated by the absence of key records. This case study illustrates that unravelling matters of considerable financial complexity, may require the services of forensic accountants who can trace transactions through many steps and then interpret and explain in plain language the financial implications of what has happened. Similarly, if you are trying to trace assets through a complex business structure or complicated sequence of transactions, a forensic accountant may have the best skills for the job.

You can contact McMahon Worth Forensic Accountants by telephone on (02) 92680671, by email at info@mcmahonworth.com.au, or go to their website at www.mcmahonworth.com.au.