

War Story 4 – Fraud, Tax Return Preparation

Subject:

Fraud

Service:

Tax return preparation

Situation:

John Able, CPA, has been preparing tax returns for Bush & Company, a pharmaceutical company, for nine years.

Bob Goode, the general partner of Bush & Co., and Eldon Edwards, another of the partners, have been good friends since the company was founded nine years ago. They share a love of travel and the finer aspects of life, including lavishing their wives with fine wines and dinners at posh resorts in exotic ports of call.

Both families have decided to take early retirements from Bush & Co. in a few years. However, they are faced with the reality that their carefree attitude toward spending has left them with woefully inadequate retirement savings or investments. They realize that even if they begin saving in earnest now, their current remuneration from Bush & Co. will not carry them far into their golden years in their envisioned style. They need more money, fast.

Bob and Eldon devise a scheme that will enable them to use the business to obtain money for their personal use. They'll obtain a credit line purportedly for Bush & Co.'s expansion. They'll gradually draw down on the credit line, fattening their retirement savings accounts and investing in real estate and money market funds.

The two prepare financial statements that will lead their savings and loan company to believe the business is on a more solid financial footing than it is. Bob doesn't want to give any sharp-eyed banker cause for suspicion, so he prepares the statements on John's letterhead, which he slipped into his briefcase after distracting John's secretary during a visit to the CPA's office. Bob and Eldon arrive at the savings and loan armed with their phony financial statements and Bush & Co.'s tax returns for the past three years, which they have altered to enhance their chances for a loan. Satisfied with the submitted financial data, the savings and loan approves a \$10 million credit line.

A year later, Bob and Eldon have found many uses for nearly half the loan. The savings and loan falls into receivership because of several bad loans it has made. The receiver investigates recipients of major loans, including Bush & Co. Bob cannot produce documentation supporting Bush & Co.'s use of the loan money. When John is questioned about some of the data on the financial statements, he disavows any involvement with their preparation. During questioning about the tax returns, he compares his file copies of the tax forms he prepared for Bob and Eldon with those submitted by his clients to the savings and loan, and discovers the alterations.

The scheme unfolds, and the receiver targets Bob, Eldon, and John to recover the loan money.

Complaint:

The receiver sues Bob, Eldon, and John for \$11 million, for conspiring to defraud the savings and loan.

Results:

John's defense proves that he is neither negligent nor responsible. He proves he didn't prepare the financial statements, and the tax returns he prepared were subsequently altered without his knowledge. Although John is shown to be innocent, \$100,000 in defense costs are needed to clear him of the charges. Additionally, he lost nearly 150 billable hours because of the time spent preparing his defense. Bob and Eldon are found guilty of defrauding the savings and loan.

Loss Prevention Tips:

Do not overlook the importance of thorough client screening. Had John scrutinized Bush & Co. he may have uncovered clues about the character of the company's management, such as Bob's and Eldon's expensive lifestyles. Prepare an engagement letter for every engagement, even if it's a tax engagement. In John's case, he had only a verbal agreement to do tax returns. The engagement letter would have limited his liability to tax return preparation, thereby expediting his ability to prove his innocence and reducing his defense costs.

Contact your insurance company or legal counsel for advice as soon as you discover any illegal activity on the part of your client, such as falsified financial statements or altered tax returns.

They will also advise you on preparation of an appropriate disengagement letter.