

**5<sup>th</sup> April 2007**

## **Beware the “soft underbelly” in fraud cases**

**Greg Lacey, Managing Director, FAR Consulting**

It is often the case that when instructed as an expert accountant for the Defence in an alleged fraud case I will be directed to only investigate specific aspects of the case, typically those identified by the Prosecution as being supportive of its case, in the hope that a specific piece of evidence appears to support the Defendant's version of events.

However, when reviewing a specific issue, an expert accountant often has to review wider financial information in order to understand the context to any opinion he might form.

As a result of this, the accountant obtains insight into rather more than the isolated issue he has been specifically asked to address by the Defence team. It is here that secondary evidence can come to light which can compromise other areas of the Defendant's case. I think of the wider financial information in fraud cases as the “soft underbelly” – without a full understanding of which there is always the risk of overlooking something relevant to the case.

By way of an example, in an alleged MTIC fraud, I was instructed to review HMRC's reconstruction of a set of accounts.

Their reconstructed figures appeared to show a gross loss of some £1.0 million in monetary terms – a helpful conclusion in the context of trying to portray the trader as being involved in a carousel fraud. However, the internal accountant instructed by HMRC had included the purchase of a consignment of computer chips, but had failed to take account of the value of the chips within closing stock (in itself unusual for a trader allegedly involved in a carousel fraud). Although a box of CPUs is small in size, it had a value of £2 million, which, if adjusted for in the reconstructed accounts would imply a gross margin of £1 million instead of the apparent £1 million gross loss.

So far, so good. Unfortunately, during the course of our work we identified a series of other transactions/issues which although not instructed to comment upon, certainly fell within an expert accountant's area of expertise. These issues included the making of third party payments, third party loan funding which appeared interest free and had no repayment term – in fact had no documentation at all to support it, and, perhaps more subtly, the accounting records themselves.

Whilst the VAT returns and the VAT records were up to date and perfectly maintained, these records almost stood alone and were completely independent of the banking records and the underlying accounting records which had barely been maintained at all. The very fact that the accounts had needed to be reconstructed at all spoke volumes with regard to how poor the general bookkeeping had been. This may not have been obvious to a non accountant, but given the exactness with which the VAT records had been maintained, it just didn't make sense from a record keeping point of view not to maintain the other accounting records to the same standard. In short, had the business traded to a period end, there would have been an almighty headache when trying to produce year end accounts. Accounts which, but for minimal effort, could have been straightforward to produce given that the VAT records had been prepared in a meticulous manner.

If asked about this, based on my experience in general practice, my conclusion would have had to have been that the accounting records were not really consistent with what you might expect to see if someone had been truly interested in the day to day performance of the business, let alone interested in complying with the record keeping requirements of the Companies Act.

Once all these secondary points were brought to the Defence's attention, it became clear that evidence that had at first appeared potentially helpful actually had a rather bleaker angle to it. However, things were probably not as bleak as they might otherwise have been had it been left until cross examination for these other points to come out. After all, there are ways and means of introducing accounting evidence without necessarily calling an accountant as an expert witness.

This raises a couple of further points worth bearing in mind, where exposing the "soft underbelly" can be painful but overall is probably helpful to the case because it enables the following:

to fully understand the risk of producing expert accounting evidence;

in identifying points that up until now have not been put forward by the Prosecution, but which may well be raised later in Court. To be forewarned etc; and

to help establish a better informed overall picture when it comes to reviewing a pleading.

Occasionally, just occasionally, an experienced forensic accountant will identify issues and aspects arising from a review of the wider financial information that will provide support to a Defence team's case that until now had been overlooked, which although particularly subtle, will be no less valid.

To ensure the chances of missing any of these angles, it is probably always worth taking time to discuss a case in outline with a forensic accountant. This should generate ideas and angles which you can then consider and make your initial assessment whether any are worth reviewing further. The only point I would make here is that you don't know unless you check and, ultimately, it is more than likely that it will be in your client's best interests to understand the full extent of the "soft underbelly" come what may.

ENDS

**Greg Lacey is managing director of FAR Consulting. He has been instructed to act in a number of alleged fraud/theft cases and in confiscation proceedings. The company acts for a number of mobile phone traders and has particular expertise in this sector. FAR Consulting also provides in-house forensic accounting services to a number of UK law firms and insurers, advising on a breadth of accounting related issues.**