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CHAPTER ONE

Overview of the Companies

BEFORE BEGINNING any analytical testing of financial information, a financial forensic examiner needs to consider preliminary discussions with management to gather information that may become useful in analyzing financial information. For use within this book, a *financial forensic examiner* is any individual who wants to pursue a detailed analysis of a set of financial statements to determine not only the *consistency* of the financial information but also possible *anomalies* that may suggest the possibility of fraudulent activity. Discussions should provide information relating to general company operations, allowing the financial forensic examiner to understand management's philosophy and general operating style. These discussions should also include financial matters, such as profit margins built into pricing products and any unusual transactions or changes that might have occurred during the period under examination. These discussions may reveal information that the financial forensic examiner will need to assess in determining the results of analytical testing of financial information.

Herein lies a lesson for the financial forensic examiner: *Anomalies in financial information may occur and may not be representative of fraudulent activity.*

THE FOUR COMPANIES

Before beginning any of the analytics noted in future chapters, this chapter is dedicated to providing general information about each company, including basic financial information and an overview of each company's general operations. Specific information for each case is available so the financial forensic examiner may follow each case study through the analytical process of finding anomalies in the financial information. This chapter will provide the foundation for interpretations made from the various tools and techniques shown throughout the book.

Company 1

Company 1 is a communications company whose primary revenues relate to advertising. The company is an S-corporation and includes three shareholders. Shareholder 2 maintained the financial information for the company. Throughout the history of the corporation, various shareholders sold their shares to new shareholders, with the exception of Shareholder 2, who would add any rounding of shares to Shareholder 2's total shares, increasing the total shares over time. Shareholder 2 was also the corporate secretary and treasurer, even though both corporate positions were not to be held by the same person, according to the Articles of Incorporation. The other two shareholders did not protest this arrangement.

Even though Company 1 filed annual tax returns, management did not review monthly, quarterly, or even annually prepared financial statements. Shareholder 3 suspected the financial information was flawed and began retaining information related to the company for an independent external review. Having gathered sufficient information, Shareholder 3 presented the documents to an external auditor for review.

Since formal financial statements had never been prepared for management, information subject to examination included sales journals, customer ledger cards, tax returns, bank statements, cash disbursement journals, and payroll journals. Even though an accounting software package maintained the financial information, Shareholder 2 would not supply a backup of the files. Financial information shown in the following tables came from the tax returns provided by the client and adjusted to book basis using the M-1 reconciliations on the tax returns.

Figure 1.1 illustrates the reconstructed balance sheet for the periods under investigation and condensed for presentation purposes.

Figure 1.2 shows the reconstructed income statements for the periods under investigation and condensed for presentation purposes. More detail has been included for additional discussions in Chapter 2.

After the recomputation of the financial statements, an integral part of the investigative planning stage used various analytical tools and techniques employed to determine specific focus areas for further investigations. Due to the nature of inconsistent postings of similar expenses in various categories during a fiscal year, the income statement presented contains some reclassifications among account balances for comparisons. The results of these tools

	YR 1	YR 2	YR 3	YR 4	YR 5
Assets					
Cash	$ 13,478	$ 1,195	$ 3,519	$ 330	$ (5,299)
Accounts Receivable	18,011	24,345	29,994	33,807	28,138
Total Current Assets	31,489	25,540	33,513	34,137	22,839
Fixed Assets (net)	122,019	121,058	116,855	113,473	114,437
Total Assets Liabilities	$153,508	$146,598	$150,368	$147,610	$137,276
Accounts Payable	$ 12,545	$ 10,612	$ 5,447	$ 7,642	$ 10,441
Total Current Liabilities	12,545	10,612	5,447	7,642	10,441
Notes Payable	—	17,641	31,192	30,554	32,862
Total Liabilities	$ 12,545	$ 28,253	$ 36,639	$ 38,196	$ 43,303
Shareholders Equity	140,963	118,345	113,729	109,414	93,973
Total Liabilities & SE	$153,508	$146,598	$150,368	$147,610	$137,276

FIGURE 1.1 Condensed Balance Sheets for Company 1

	YR 1	YR 2	YR 3	YR 4	YR 5
Sales	$145,246	$121,842	$130,859	$128,344	$138,443
Less Purchases	9,017	12,249	17,248	5,752	5,820
Less Labor Costs	4,542	8,143	6,115	10,292	2,988
Gross Profit	131,687	101,450	107,496	112,300	129,635
Expenses					
Selling Expenses	$ 1,712	$ 2,657	$ 2,001	$ 8,939	$ 12,730
General & Administrative	41,946	38,122	36,668	40,829	30,378
Salaries	9,820	15,592	8,266	4,234	43,490
Repairs & Maintenance	5,842	6,453	1,132	6,243	3,603
Bad Debt	—	—	—		4,280
Rent	2,976	2,000	5,000	7,504	1,615
Taxes & Licenses	5,937	10,312	5,791	6,149	8,284
Insurance	2,570	7,072	4,883	5,371	5,242
Utilities	15,782	16,487	16,823	18,131	17,177
Supplies	4,590	7,190	8,368	4,956	4,066
Depreciation	4,863	4,664	10,805	5,882	6,831
Accounting Fees	1,050	2,036	1,320	1,470	1,110
Vehicle Expense	2,291	4,929	—	—	—
Civic Donations	580	1,070	770	520	130
Legal Fees	709	—	—	—	—
Internet Fees	161	—	21	—	—
Office Expenses	689	—	—	—	—
Freight	78	—	—	22	—
Postage	209	—	244	403	386
Lodging &Travel	—	—	—	300	625
Commissions	522	—	54	380	870
Total General Expenses	100,615	115,927	100,145	102,394	128,087
Total Expenses	102,327	118,584	102,146	111,333	140,817
Interest Income	949	—	752	374	—
Interest Expenses	5,360	5,484	5,083	5,656	4,259
Net Profit	$ 24,949	$(22,618)	$ 1,019	$ (4,315)	$(15,441)

FIGURE 1.2 Condensed Income Statements for Company 1

and techniques are the focus of the case study for Company 1 throughout the remaining chapters.

Other developments in the examination included the finding of a checking and savings account that was in the company's name but not recorded in the financial information, and another entity set up as a partnership for the three shareholders to maintain the rental property owned by the S-corporation.

Herein lies a lesson for the financial forensic examiner: *Financial records are not always entirely conclusive for all transactions.*

Although the rental property was not vacant during the periods under investigation, the company did not complete tax returns for the partnership and did not keep financial records for the partnership. The use of *off-book* bank accounts allowed Shareholder 2 to remove funds from these accounts and then deposit these funds into the company, recording a note payable to Shareholder 2, although the funds in these accounts were actually revenues from advertising sales and rental income for the partnership.

As the investigation progressed, interviews with Shareholder 2 revealed that the intent of the fraud was to reduce the net worth of the company so that Shareholder 1 and Shareholder 2 would be able to purchase the shares of the heir of Shareholder 3 at a fraction of their true net worth. The local district attorney received a report of the examination findings and ultimately the shareholders' attorney negotiated the case before any court appearance. The plea-bargain arrangements removed the note payable to Shareholder 2 from the company's financial records, and required the hiring of an additional employee to manage the finances of the company, thus removing all operational and corporate authority from Shareholder 2.

Company 2

Company 2 is a manufacturing company with a niche in the market as the sole source for specific parts for large equipment, such as excavators, wheel loaders, cranes, and so forth. As a sole-source provider of these specific products, the company has a select customer base, maintaining a good working relationship with its customers and recording very little, if any, bad debt. The company monitored its receivables continuously and many of its customers paid their balances within the 30-day period, or the amounts due were collected at the time of delivery. Due to the nature of its manufacturing products, cost of sales and gross margins are consistent among the various models of its product lines.

The company is a C-corporation and did not have external audits of its financial records, just external compilations and reviews of its financial information. The financial information compiled for management's reviews consisted of specific ratios requested by management relating to liquidity, such as the current ratio, the quick ratio, income before tax to net worth, the debt coverage ratio, and the leverage ratio. The financial information related to the reviews did not include cash flow statements as part of the basic reports, nor did it include ratios relating to performance, such as gross margins and measurements of profitability.

Only the accounting staff had access to the financial information maintained through a commercial accounting software package. The accounting staff had access to various modules of the software, but not the complete accounting package. The office manager and the chief financial officer (CFO) both had unrestricted access to the accounting software. Other basic internal controls in place included appropriate segregation of duties relating to receiving cash, depositing cash, writing checks, and performing bank reconciliations. The CFO would use the signature stamp (kept locked in a filing cabinet in the office) to sign the checks. The CFO would ensure that each check had all support documentation attached before the checks were stamped. Only the office manager and the CFO were able to record manual journal entries in the accounting system.

The company issued hundreds of checks monthly, so staff did not sort the canceled checks in numerical order but relied on the bank statement listing of cleared checks to reconcile the financial records. By not sorting the canceled checks, staff did not notice whether any canceled checks were missing from the stack. When performing the reconciliations, staff would tick and tie check

Herein lies a lesson for the financial forensic examiner: *Internal control systems and documented procedures have inherent limitations to consider in the overall investigative process.*

numbers and amounts in the bank statement to the accounting records, using only the listing in the bank statement and not the individual canceled checks supplied in the bank statements.

Knowing the operational procedures of the accounting department, the office manager took advantage of the "opendoors," or weak areas within the company's internal control structure, and for many years embezzled monies from the firm. By having unrestricted access to backing up and restoring the financial records, the office manager was able to write personal checks, restore a backup of the financial records, and record fictitious vendor checks in the financial records, thus replacing the personal checks in the financial records with the fictitious checks. By removing the canceled personal checks from the monthly bank statements prior to giving the statements to the appropriate staff for reconciling, no one noticed any canceled checks missing. The company suspected fraudulent activity based on one transaction the office manager posted to the fixed assets in the general ledger in covering up one of the personal checks. In reviewing the general ledger transactions, the CFO noticed the posting of a purchase to fixed assets and knew that he had not authorized the purchase.

Figure 1.3 shows the balance sheets for the periods under investigation, condensed for presentation purposes.

Figure 1.4 illustrates the income statements for the periods under investigation, condensed for presentation purposes.

Due to the nature of the fraudulent activity and the attempted cover-up of lost funds, various analytical tools and techniques used in the planning stages of the investigation defined areas in the financial information that would require further inspection and detailed analysis. Further investigations of detailed documents revealed that a second, unauthorized signature stamp had been used to process personal checks. The office manager destroyed all backup copies of the financial records saved to the office manager's personal computer, along with the signature stamp. E-Discovery techniques were not successful in recreating all of the backup copies, but sufficient information recovered included excessive personal purchases, revealing a rather extravagant lifestyle.

Common in cases of embezzlement, the company owners respected and trusted the office manager, considered the office manager to be an excellent employee, and gave quarterly bonuses for outstanding performance. Although at first management was reluctant to press charges and prosecute the office manager, management did change its views as the office manager did not return any of the embezzled funds as promised. In the end, the court convicted the office manager and sentenced the individual to 10 years in prison, but the court

	YR 1	YR 2	YR 3	YR 4	YR 5
Assets					
Cash	$ 6,037	$ 219,408	$ 409,620	$ 1,615,708	$ 866,801
Accounts Receivable	1,388,977	2,905,601	2,282,772	2,158,034	2,275,985
Allowance for Bad Debts	(1,000)	(60,000)	(37,172)	(100,000)	(100,000)
Refundable Income Taxes	—	—	21,205	47,000	40,000
Inventory	1,866,785	3,904,040	3,282,898	3,887,568	5,159,037
Prepaid Expenses	256,677	309,566	176,110	73,826	75,412
Total Current Assets	3,517,476	7,278,615	6,135,433	7,682,136	8,317,235
Other Assets	—	—	—	—	963,459
Fixed Assets (net)	1,786,908	2,210,753	2,472,082	2,501,071	2,421,222
Total Assets	$5,304,384	$9,489,368	$8,607,515	$10,183,207	$11,701,916
Liabilities					
Accounts Payable	$1,186,293	$2,987,894	$1,902,907	$ 1,951,605	$ 1,352,480
Deferred Income Taxes	—	—	—	30,000	—
Other Liabilities	26,150	124,856	64,452	86,796	461,000
Total Current Liabilities	1,212,443	3,112,750	1,967,359	2,068,401	1,813,480
Deferred Income Taxes	488,762	873,317	1,270,317	424,317	604,000
Notes Payable	619,508	17,19,098	—	—	—
Total Liabilities	2,320,713	5,705,165	3,237,676	2,492,718	2,417,480
Stockholders Equity	2,984,671	3,784,203	5,369,839	7,690,489	9,284,436
Total Liabilities & SE	$5,305,384	$9,489,368	$8,607,515	$10,183,207	$11,701,916

FIGURE 1.3 Condensed Balance Sheets for Company 2

also allowed probation, so the office manager did not serve any time in prison. As part of the sentence, the office manager had to pay restitution to the company for the diverted funds. The company never received payments; the office manager moved out of state, and no other court intervention occurred.

Company 3

Company 3 is a local governmental entity requiring specific financial reporting. The magnitude of the embezzlement makes this a great case study for the

	YR 1	YR 2	YR 3	YR 4	YR 5
Sales	$10,950,180	$28,188,122	$40,214,834	$38,780,333	$30,397,677
Less Cost of Sales	8,737,104	23,312,675	33,082,011	31,270,725	24,613,108
Gross Profit	2,213,076	4,875,447	7,132,823	7,509,608	5,784,569
Expenses					
General & Administrative	1,764,716	3,534,123	4,555,539	3,722,301	3,358,667
Depreciation	203,295	240,233	306,697	339,156	375,978
Income Tax Expense	162,287	523,542	950,439	1,313,500	890,000
Total Expenses	2,130,298	4,297,898	5,812,675	5,374,957	4,624,645
Misc Income	117,305	221,983	265,491	185,999	434,023
Net Profit	$ 200,083	$ 799,532	$ 1,585,639	$ 2,320,650	$ 1,593,947

FIGURE 1.4 Condensed Income Statements for Company 2

analytical tools and techniques examined in this text, especially since external auditors also audited the local government's financial information annually and never found the embezzlement activities. Another reason for including this company is to show the financial forensic examiner that the analytical tools and techniques discussed in this book are applicable to all types of entities and types: public or nonpublic entities, corporations, partnerships, sole proprietorships, manufacturing, and government, nonprofit, and even financial institutions.

The local government's treasurer and comptroller maintained the financial records. The comptroller, accused of embezzling anywhere from $30 to $50 million or more from the local government, has pleaded guilty to all charges of stealing funds from the government. The audited financial statements completed by an external auditor noted no findings of internal control deficiencies or instances of noncompliance. The local government filed a lawsuit against its auditors for professional negligence and negligent misrepresentations in the auditor reports. However, one important factor overlooked was the effectiveness of the local government's management in monitoring the activities of the local government.

Since governmental financial statements require special presentation, both at the fund level and at the primary government level, the financial statements for Company 3 require presentation at both levels, totals only. The total governmental funds financial statements require presentation using the modified cash basis of accounting and include only the governmental funds. These funds included a general fund, special revenue funds, debt service funds, and a capital projects fund. The business-type activities (proprietary funds and enterprise funds) in the financial statements require presentation using the full accrual basis. Statements of cash flows are required for proprietary funds but not for governmental funds.

The primary government financial statements also include both governmental activities and business activities. The governmental activities financial statements, presenting the local government as a whole, included the general government, public safety, highways and streets, traffic development, welfare, culture and recreation, and airport and cemetery services. The business-type activities included a landfill, sewer, and water services.

The difference is that governmental activities require presentation using the full accrual method. The financial statements must include reconciliations of the modified cash basis of presentation to the accrual basis of accounting.

Figure 1.5 shows the primary government balance sheets and Figure 1.6 shows the governmental funds balance sheets for the periods under investigation.

Figure 1.7 shows the primary government income statements while Figure 1.8 shows the governmental funds income statements for the period under investigation. The structure of the income statements differs from the required structure, making the analytical tools easier to follow.

As with Company 1, diverted funds went to a specific bank account not recorded in the financial statements. By transferring governmental funds through the various bank accounts into this off-book bank account, the manager embezzled governmental funds for many years. The manager also created fictitious invoices to hide the embezzled funds, recording fictitious expenses in general expenses and capital outlay.

Company 4

No analytical study would be complete without having some sort of benchmark to use for comparison with the results of data analyses. Company 4 is the benchmark used in this book because the financial information for the

	YR 1	YR 2	YR 3	YR 4	YR 5
Assets					
Cash	$ 7,127,424	$ 5,829,038	$ 3,503,752	$ 1,282,307	$ 1,299,373
Investments	3,026,409	6,883,554	5,376,081	802,697	550,593
Accounts Receivable	6,193,387	5,675,948	5,770,644	6,221,333	7,481,059
Allowance for Bad Debts	(2,500)	(2,500)	(2,500)	(52,500)	(77,500)
Inventory	176,657	181,274	140,525	148,483	183,381
Prepaid Expenses	172,006	181,279	222,326	103,951	104,732
Total Current Assets	16,693,383	18,748,593	15,010,828	8,506,271	9,541,638
Restricted Cash	166,608	192,647	209,721	287,989	289,919
Notes Receivable	67,528	38,837	33,202	10,368	7,726
Restricted Investments	222,359	225,587	227,670	163,779	170,170
Fixed Assets (net)	67,637,960	69,924,748	79,045,344	85,833,195	91,983,964
Total Assets	$84,787,838	$89,130,412	$94,526,765	$94,801,602	$101,993,417
Liabilities					
Accounts Payable	$ 563,946	$ 761,336	$ 1,332,591	$ 643,130	$ 1,422,480
Accrued Liabilities	664,625	664,470	750,486	858,797	944,611
Due to Pension Fund	—	—	—	—	264,032
Long Term Due in 1 Year	1,579,370	2,861,106	2,350,037	2,580,092	6,454,289
Total Current Liabilties	2,807,941	4,286,912	4,433,114	4,082,019	9,085,412
Deferred Revenues	4,651,080	4,020,322	4,109,313	4,169,035	4,324,932
Long Term Liabilities	24,126,024	28,850,525	32,039,458	30,943,153	29,059,876
Total Liabilities	31,585,045	37,157,759	40,581,885	39,194,207	42,470,220
Net Assets	53,202,793	51,972,653	53,944,880	55,607,395	59,523,197
Total Liabilities & Net Assets	$84,787,838	$89,130,412	$94,526,765	$94,801,602	$101,993,417

FIGURE 1.5 Primary Government Balance Sheets for Company 3

company is clean. A "clean" set of financial statements indicates that the financial information of the company is free from material misstatements and free from fraudulent transactions. To ensure that Company 4 is a suitable benchmark for comparison, the company is a publicly traded entity with

	YR 1	YR 2	YR 3	YR 4	YR 5
Assets					
Cash	$ 2,305,503	$ 3,073,334	$ 2,134,862	$ 816,508	$ 594,169
Investments	2,839,407	6,688,938	5,174,742	532,041	284,067
Accounts Receivable	4,514,877	4,966,972	5,060,185	5,373,058	5,679,331
Due from Other Funds	3,288,257	3,924,350	4,719,495	7,739,995	9,472,608
Inventory	23,331	38,520	20,316	48,458	60,221
Prepaid Expenses	140,855	146,444	166,472	53,949	57,488
Total Current Assets	13,112,230	18,838,558	17,276,072	14,564,009	16,147,884
Notes Receivable	67,528	38,837	33,202	10,368	7,726
Total Assets	$13,179,758	$18,877,395	$17,309,274	$14,574,377	$16,155,610
Liabilities					
Accounts Payable	$ 298,718	$ 297,522	$ 899,478	$ 450,921	$ 295,905
Accrued Liabilities	323,311	377,450	404,528	522,458	597,552
Due to Other Funds	2,328,257	3,404,495	4,234,495	7,434,497	8,908,530
Total Current Liabilties	2,950,286	4,079,467	5,538,501	8,407,876	9,801,987
Deferred Revenues	3,359,531	3,659,683	3,732,514	3,777,793	3,926,262
Total Liabilities	6,309,817	7,739,150	9,271,015	12,185,669	13,728,249
Total Fund Balances	6,869,941	11,138,245	8,038,259	2,388,708	2,427,361
Total Liabilities & Fund Balances	$13,179,758	$18,877,395	$17,309,274	$14,574,377	$16,155,610

FIGURE 1.6 Governmental Funds Balance Sheets for Company 3

audited financial statements and subjected to the requirements of the Sarbanes-Oxley Act of 2002, meaning that the internal controls of the company are tested not only for the effectiveness of design, but also for operating effectiveness. The financial statements presented for comparison contained no material weaknesses or significant control deficiencies in the years tested.

Herein lies a lesson for the financial forensic examiner: *Results of analytical testing must be applied to benchmarks for concluding on the testing.*

	YR 1	YR 2	YR 3	YR 4	YR 5
Revenues					
Charges for Services	$6,084,880	$5,704,315	$6,139,777	$5,828,204	$6,923,015
Taxes	9,129,602	10,461,415	10,500,843	10,073,437	10,603,535
Interest Income	577,099	410,530	370,676	149,676	86,778
Other Revenues	869,006	403,249	494,776	1,347,473	700,999
Transfer from Private Trust Fund	—	—	—	—	200,000
Grants & Contributions	30,421	69,478	2,463,413	1,183,513	3,341,682
Total Revenues	16,691,008	17,048,987	19,969,485	18,582,303	21,856,009
Expenses					
General & Administrative	10,488,090	13,021,732	13,080,004	11,560,648	12,360,554
Depreciation Expense	3,702,017	3,966,022	4,333,368	4,810,923	5,303,901
Interest Expense	93,559	410,930	583,886	548,217	275,752
Total Expenses	14,283,666	17,398,684	17,997,258	16,919,788	17,940,207
Change in Net Assets	$2,407,342	$ (349,697)	$1,972,227	$1,662,515	$3,915,802

FIGURE 1.7 Primary Government Income Statements for Company 3

Company 4 is a C-corporation with consolidated subsidiaries, including foreign subsidiaries. For future reference, the notes to the financial statements included these comments:

- The external auditor issued a going-concern opinion in YR 1.
- The subsidiary (not one of the foreign subsidiaries) filed for liquidation in YR 3.
- Trustee's final report for the subsidiary's liquidation approved the liquidation in YR 4 and allowed the company to deconsolidate the subsidiary from the financial statements with a non-cash gain.
- The effective tax rate increased in YR 5 from an average over the prior years of 10.5 to 36.3%.

Company 4 is an industry leader in a specialized market manufacturing specific types of products for sale. In contrast to Company 2, Company 4 has a large customer base, using a network of domestic and foreign independent

	YR 1	YR 2	YR 3	YR 4	YR 5
Revenues					
Charges for Services	$ 431,025	$ 453,688	$ 446,319	$ 453,633	$ 428,142
Taxes	3,137,291	3,339,281	3,524,222	3,716,189	3,756,412
Licenses, Permits, Fees	283,344	281,260	266,924	270,910	282,192
Fines & Penalties	159,788	181,919	148,360	159,894	129,461
Other Revenues	620,379	537,394	667,642	1,306,048	614,931
Intergovernmental Revenues	6,493,027	7,191,612	9,440,034	6,507,210	8,333,667
Total Revenues	11,124,854	11,985,154	14,493,501	12,413,884	13,544,805
Expenses					
General & Administrative	7,398,658	9,123,875	8,625,966	9,738,780	9,736,115
Pension and SS Payments	970,971	1,012,097	1,042,311	1,109,795	1,123,927
Capital Outlay	5,171,038	6,032,238	8,645,654	7,634,565	5,376,412
Debt Service	623,000	397,000	691,000	647,000	1,154,666
Interest Expense	375,710	346,640	523,556	558,295	264,032
Total Expenses	14,539,377	16,911,850	19,528,487	19,688,435	17,655,152
Excess (Deficiency)	(3,414,523)	(4,926,696)	(5,034,986)	(7,274,551)	(4,110,347)
Operating Transfers In	6,350,000	7,815,000	7,341,000	5,935,000	6,479,000
Bond Proceeds	—	6,500,000	—	—	1,679,000
Operating Transfers Out	4,753,000	5,120,000	5,406,000	4,310,000	4,009,000
Changes in Fund Balance	$(1,817,523)	$4,268,304	$(3,099,986)	$(5,649,551)	$ 38,653

FIGURE 1.8 Governmental Funds Income Statements for Company 3

distributors. Since the consolidated financial statements included the consolidation of foreign subsidiaries, both the balance sheets and the income statements of these subsidiaries required conversion to the functional currency of U.S. dollars. The equity section of the balance sheet shows the effect of this currency translation.

Figure 1.9 shows the condensed balance sheets for Company 4 and Figure 1.10 illustrates the condensed income statements for the company.

(in thousands)	YR 1	YR 2	YR 3	YR 4	YR 5
Assets					
Cash	$ 5,240	$ 2,812	$ 6,147	$ 8,204	$ 23,282
Accounts Receivable	39,052	50,452	67,626	86,674	68,675
Allowance for Bad Debts	(1,062)	(1,116)	(1,834)	(2,488)	(1,640)
Inventory	26,715	34,994	38,318	43,155	39,313
Prepaid Expenses	1,783	1,525	739	2,079	1,775
Total Current Assets	71,728	88,667	110,996	137,624	131,405
Other Assets	39,113	20,393	16,131	32,281	23,830
Fixed Assets (net)	20,977	18,762	17,443	27,527	33,807
Total Assets	$131,818	$127,822	$144,570	$197,432	$189,042
Liabilities					
Accounts Payable	$ 34,164	$ 36,224	$ 45,352	$ 58,620	$ 39,926
Other Liabilities	37,680	18,416	16,065	13,269	10,623
Current Portion of Debt	2,050	2,052	1,595	1,623	1,802
Total Current Liabilities	73,894	56,692	63,012	73,512	52,351
Notes Payable	29,927	24,345	16,803	10,537	4,203
Total Liabilities	$103,821	$ 81,037	$ 79,815	$ 84,049	$ 56,554
Shareholders Equity	27,997	46,785	64,755	1,13,383	1,32,488
Total Liabilities & SE	$131,818	$127,822	$144,570	$197,432	$189,042

FIGURE 1.9 Condensed Balance Sheets for Company 4

Based on the general information of each company, the following characteristics apply:

- Company 1 did not provide financial information for any type of review, nor were they audited.
- Company 1 and Company 2 did not calculate cash flow statements.
- Company 2 had an independent review of financial information.
- Company 3 provided only the required cash flow statements at the business-activities level only.
- Company 3 had financial statements audited by an external auditor.

(in thousands)	YR 1	YR 2	YR 3	YR 4	YR 5
Revenues					
Sales	$205,996	$236,308	$351,884	$409,421	$400,032
Less Cost of Sales	179,008	205,021	301,943	349,639	343,885
Gross Profit	26,988	31,287	49,941	59,782	56,147
Expenses					
General & Administrative	13,841	15,812	21,533	24,229	23,971
Depreciation	3,570	3,092	2,760	2,608	3,134
Other Expense	6,291	4,657	4,012	3,518	3,392
Income Tax Expense	1,216	740	2,936	2,454	9,319
Total Expenses	24,918	24,301	31,241	32,809	39,816
Misc Income	(16,223)	(1,511)	(114)	18,370	-
Net Profit (Loss)	$(14,153)	$ 5,475	$ 18,586	$ 45,343	$ 16,331

FIGURE 1.10 Condensed Income Statements for Company 4

- Company 1 and Company 3 did not have appropriate segregation of duties.
- Company 2 represents inherent risks in a weak internal control structure.
- Company 3 poses the question of appropriate governance and oversight.
- Company 4 is a benchmark for comparing the analyses of the other companies.

SUMMARY

The basic information for the various entities forms the foundation for the analytical techniques used throughout the following chapters. These techniques provide the financial forensic examiner with a roadmap of where anomalies exist in the financial information that may indicate possible fraudulent activity. These tools, by themselves, are not sufficient evidence for prosecution but allow the financial forensic examiner to focus further investigative work in specific areas, allowing the financial forensic examiner to be both efficient and effective in the investigative process. From the perspective of a reader and user of financial statements, the tools provide insight to prepared financial statements presented for review. These tools may indicate that additional information or explanation may be required for certain areas of the financial statements.

Not every investigation requires all of the analytical tools discussed within these chapters; therefore, the financial forensic examiner can be selective and tailor the tools and techniques to meet the needs of the engagement. Applying the results of these tests to benchmarks is a requirement for interpreting the results of these tests. Visual aids give a clearer picture of the test results compared to just using the numbers and are often needed in presenting case information to juries. The benefits of visual aids will become quite apparent as the various tools and techniques are applied to the case studies in the following chapters.

The next chapter focuses on common preliminary analytics and preliminary forensic analytics applied to each of the companies' financial information.