



Recent Case: Embezzlement of Company Funds

by Chris Hamilton, CPA, CFE, CVA, DABFA

Type of matter: Suspected embezzlement of company funds.

Summary of Issue:

Members of the board of directors contacted **Arxis Financial, Inc.** to discuss a strange pattern of information and lack of information being provided to the board. The conference call revealed that once the board began asking questions of management, the CEO resigned. After an initial discussion it was determined that the pattern suggested more than incompetence. Several facts pointed towards potential fraud.

Money involved:

Over \$200,000 was found to have been misappropriated.

Arxis' work:

We proposed a multi-stage engagement. Phase 1 was designed to establish whether there was evidence confirming fraud rather than simply incompetence or sloppiness by management. Phase 2 was designed to quantify a preliminary loss given specific parameters determined in phase 1. In simple terms, phase 2 was designed to pick the "low hanging fruit" and establish the basis for the board to determine a legal course of action, if any. Phase 3 was designed to complete the investigation and prepare for civil or criminal prosecution.

Phase 1 established that indeed there was evidence of both management sloppiness that allowed for unauthorized financial transactions, as well as evidence that such transactions had taken place. On the first day that Arxis was on-site the CFO resigned. The board was completely unaware that there were no internal controls.

In phase, 2 Arxis reviewed several years of bank reconciliations and traced cancelled checks and deposit slips back to the accounting records. This process exposed unauthorized payments as well as a sophisticated attempt to cover the payments so that reports to the board would not reflect the actual economic activity. Arxis presented the findings to the board and recommended that phase 3 was not necessary as there was no insurance to cover the loss and the board had determined that there would be no prosecution.

Result:

Arxis assisted in assuring the security of the computer network and establishing a system of internal controls and reporting that, if maintained, would eliminate the possibility of continuing problems. The board of directors terminated several members of senior management and the outside audit firm. Arxis assisted the company with the identification and hiring of qualified accounting staff and replacement auditors.

About the author:

Chris Hamilton is a partner with the CPA firm of Arxis Financial, Inc., in Simi Valley. He is a member of the California Society of Certified Public Accountants (Litigation Services Committee), and the American Institute of Certified Public Accountants. Mr. Hamilton is a Certified Public Accountant, a Certified Fraud Examiner, a Certified Valuation Analyst, and a Diplomate of the American Board of Forensic Accounting. He can be reached at ph. 805-306-7890 or chamilton@arxisgroup.com.