

WALWORTH & NAYH, P.C.

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Forensic Accounting Services

- Property & Casualty Insurance Claims Consulting
- No-Fault / Wage Loss Claims Consulting
- Litigation Support
- Training and Seminars for insurance, legal and accounting industry professionals

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Walworth & Nayh Now In Traverse City, Michigan



In order to better serve our Northern Michigan clients, Walworth & Nayh, P.C. has opened a new office in Traverse City. Our new office is located at 880 Munson, which is on the East Bay of Grand Traverse Bay, just north of the airport. Partners Mark Stephanic and Greg Wood will be managing the new office and will be available to meet your forensic accounting needs.

Walworth & Nayh, P.C. has been providing forensic accounting services throughout the United States for years, focusing on Michigan and the Midwestern states.

We have always serviced clients throughout Northern Michigan, including Traverse City, Gaylord, and all areas north of Bay City, including the Upper

Peninsula. We have a unique understanding of the Northern Michigan economy, having worked on many losses with area resorts, casinos, golf courses and other recreational businesses, as well as builders, architects, medical related businesses, etc.

From a service standpoint, be aware that our charges for travel have always been billed from our closest office location, no matter where the CPA travels from.

We look forward to working even closer with our Northern Michigan clients, and making our services even more affordable.

Call us at: (231) 947-8990.

Understanding Financial Statements

Although it is a topic which might make your eyes glaze over, it is important to have a basic understanding of what financial statements are (and are not) in order for them to be useful to you.

The term “financial statements” has a specific meaning to CPAs and trained accountants. However, in informal usage, it is frequently interpreted differently by business owners and non-accountants. Usually, business owners will take a request for financial statements to mean an income statement and a balance sheet. But, ask ten business owners to simply provide “financial statements” and you are likely to get ten different responses. Therefore, knowing what to ask for is the starting point.



The first question to ask is: who prepares the financial statements? This is frequently a function of the size of the business. There are four possibilities:

- **Nobody.** This is sometimes the case in very small businesses, particularly those that have been recently started. It is the mark of a “seat-of-the pants” entrepreneur lacking basic business knowledge and skills. This obviously complicates any forensic accounting assignment and should be regarded as a “yellow-flag” in and of itself.
- **Self-Prepared.** In the accounting profession, we generally refer to these as “internal” financial statements. The quality varies according to the level of training of those preparing the financial statements. This can run the gamut, from the owner of a one-person business who does

everything himself either manually or in a basic computer accounting software program like QuickBooks to the larger small business that may have a professional controller (an employee) supported by a well organized accounting department.

- **Non-Employee Preparer.** Most states permit non-CPAs to prepare financial statements for clients. Frequently, these enterprises are styled as “tax and book keeping” services. Generally, their primary service is preparing income tax returns (note that a tax return is not a financial statement as the term is used in accounting) and they may sometimes prepare financial statements as an additional service. However, state laws generally do not permit non-CPAs to provide “attestation” services – that is to offer an audit opinion or any other form of assurance about the financial statements they prepare. There are also no standards that govern what non-CPA preparers present in financial statements. In our experience, the quality of presentation varies from those that have a professional appearance to the downright comical.

- **CPAs.** Complete financial statements prepared by a CPA will contain the following: a Report Letter; an Income statement; a Balance Sheet; a Statement of Changes in Owner’s Equity (frequently included within the balance sheet); a Statement of Cash Flows and required Footnote Disclosures. This means that the term “financial statements” includes a report letter describing the level of service provided by the CPA, at least three distinct financial reports (Income Statement, Balance Sheet and Statement of Cash Flows) and Footnote Disclosures which may run several pages. Anything less is not a complete financial statement and that fact must be disclosed in the report letter. If you receive just an income statement or balance sheet that appears to have been prepared by a CPA firm, then you have not been provided with the complete financial statement.

Knowing who prepares the financial statements of a particular business and their relative level of accounting expertise provides a basis for formulating specific document requests and an expectation as to what you should receive in response to such requests. In the next issue, we will explore the different types of financial statements that CPAs issue.

Bob Walworth Honored by MACPA

On September 10, 2008, Bob Walworth was honored at the Michigan Association of Certified Public Accountants Awards Dinner at the Townsend Hotel in Birmingham, Michigan. Bob was honored as the outgoing Chairman of the Fraud Task Force of the MACPA.

Bob has served on the Fraud Task Force since 2000. In 2004, Bob was appointed as Vice Chairman and ascended to Chairman in 2006. Over the last four years, Bob has been in a leadership position, involved in elevating the CPA profession’s

awareness of fraud issues. The MACPA’s Fraud Task Force presents an annual conference for the profession in May of each year. In addition to his role as Chairman, Bob has presented sessions on Insurance Fraud and related litigation topics to help raise awareness of fraud issues specific to the insurance industry.

Bob will continue to serve on the Fraud Task Force, in addition to rejoining the Litigation Support Task Force of the MACPA.

Verifying Theft Losses (and detecting fraud in the process)

We often assist adjusters in verifying commercial theft losses, most commonly involving retail merchandise inventory. Since most of these types of business do not maintain computerized, perpetual inventory records, most of these claims are based on lists prepared by the insured from memory. Many times, small storeowners know their inventory well enough to prepare a relatively accurate list. Using the books and records of the business, their 'memory' can be tested. While many times this testing yields results close to the insured's claim, it sometimes yields results that may highlight inaccuracies in the insured's memory, which may elevate to the level of misrepresentation and fraud.

The first step in verifying the theft loss is to get an immediate estimate of the amount of loss. Even though it may be a rough estimate, this can help the adjuster decide on the next step. The key consideration here is the size of the loss and whether the cost to have the inventory counted is warranted.

If the loss is expected to be substantial, a **COMPLETE physical inventory** should be counted of all goods in the store. At the same time, make sure there are no other locations, either for storage or sales. If there are other locations, goods stored there should also be counted.

In many cases, the insured and a representative of the insurance company (Adjuster, CPA, Salvor, etc.) perform the count jointly, with the goal of a complete, agreed count of all items on hand. The key is that the inventory count must be done in an organized manner, and must include all goods owned by the insured. Having the insured's employees count the goods has the benefit of their familiarity with the goods, the pricing system, and the location of all merchandise.



In some cases, it is not practical for the insured's personnel to count the inventory. In those cases, carriers may hire a CPA firm, salvage company or independent adjusting firm to count the merchandise. The carrier still should demand the assistance of some personnel of the insured to ensure a complete count. Once the inventory count has been completed,

it is highly recommended that you have the insured sign-off on the inventory count sheets to indicate their agreement with the count. Without this step you may face arguments later in the adjustment process (or in trial) regarding the accuracy of the inventory.

By counting the inventory and pricing it at cost, you have established the value of that inventory on hand. The next step is to compare it to what the insured's books and records reflect as of the same day. If a theft loss has occurred, the **value remaining on hand should be less than what the books show.**

To establish the book value of inventory, you 'rollforward' the inventory from the last pre-loss count, as follows:

- Start with the amount of the last physical inventory prior to the loss
- Add all purchases of merchandise since the last inventory count
- Deduct sales of merchandise (at cost) since the last inventory count.

The difference between the books and your post-loss physical count is the amount of loss.

We review all of the documents presented for consistency, reasonableness and accuracy. For example, purchase invoices will be tested in a number of ways, including:

- Comparison to financial statements
- Comparison to disbursement records
- Inspecting invoice number sequences, dating sequences, consistency of amount, etc.
- Questionable invoices will be noted and investigated further.

In prior claims, these types of testing procedures have revealed a variety of fraud scams, including alteration and fabrication of invoices.

Another issue that sometimes arises is that the insured will represent that the inventory value reported for tax purposes is not accurate and understated. This is offered as the reason why the books don't show a loss.

From a tax standpoint, underreporting of inventory values has the effect of reducing income, and therefore reducing the ultimate tax liability. However, by 'sharing' this information with you, the insured is admitting to tax fraud. Absent any other corroborating evidence, the insured is asking you to 'believe' this representation for purposes of validating his claim, while telling you that he previously misrepresented facts under penalty of perjury to the Federal government.

It is imperative that a complete physical inventory be counted to verify a theft loss claim. Once the remaining inventory value after the theft is established, it is then compared to the books to determine the amount of loss. By taking all of the necessary investigative steps to verify information provided by the insured, you will insure that valid claims are paid, and that any misrepresentation or fraud in the submission of the claim will be detected.

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At Walworth & Nayh, P.C., we specialize in Forensic Accounting Services, including Insurance Loss Accounting and Litigation Support.

We regularly provide expert testimony in deposition, trial and alternative dispute resolution venues. Our forensic specialists apply their knowledge of accounting, finance, information technology, and business to the investigation of specific issues related to insurance claims and litigation matters. Opinions are developed by thorough analysis combined with judgment and experience.

Our clients include insurance companies and their adjusters, private companies who have experienced a loss, and attorneys representing both plaintiffs and defendants involved in business disputes.

Unlike traditional accounting firms, we are exclusively devoted to helping clients resolve disputes by providing technical expertise in the relevant accounting and damages issues.

For further information, we invite you to contact one of our partners at the numbers listed above, or by e-mail at amoceri@walnay.com.

Firm News

We have been active in providing continuing education opportunities for clients. In July, Gary Nayh, Greg Wood and Nick Mouzourakis presented two seminars for Nationwide Insurance Company on No-Fault Wage and Survivors losses. In September, Greg Wood and Nick Mouzourakis also presented a No-Fault Wage and Survivors Loss seminar for Titan Insurance. If you are interested in having Walworth & Nayh present an in-house seminar on a topic of your choice, please phone or e-mail Anne Mocerri. Seminars can be tailored to your specific needs. In the past, we have provided seminars on Understanding Tax Returns, Business Interruption Losses, Theft Claims as well as No-Fault Wage and Survivors Losses.

We would like to welcome our newest employee in the Livonia office, Jeffrey D. Myslinski. Jeff is a graduate of the University of Michigan with a bachelors degree in finance and holds a masters degree in accounting from Wayne State University. Jeff is a hockey enthusiast and a serious Red Wings fan.

Double congratulations to Tracy (Branderhorst) Cravioto of our Grand Rapids office. Tracy has been very busy of late. She was married to Jesus Cravioto in June and also recently completed the requirements to obtain her license as a Certified Public Accountant.

Our Grand Rapids office has a new address - the office was recently expanded to a larger suite (suite 306) within the same building.

Other News

Note that there is a new statutory maximum no-fault wage loss benefit. Effective October 1, 2008, the maximum benefit increased to \$4,989 per 30-day period. This represents a 5.86% increase over the previous year's maximum rate.