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# Fraud affecting the assets

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| | Total | | January | | February | |
|---|---|---|---|---|---|---|
| | Budget | Actual | Budget | Actual | Budget | Actual |
| Sales | | | | | | |
| Cost of goods sold | | | | | | |
| Gross profit | | | | | | |
| Selling expenses | | | | | | |
| Administrative expenses | | | | | | |
| Total | | | | | | |
| Net profit | | | | | | |

Budget figures are entered in advance; actual figures as they become available. In the absence of complete actual monthly figures, certain items only may be used, or the form may be contracted to a quarterly, semi-annual, or even an annual basis. However, as departure from the monthly basis becomes greater, the value of the scheme becomes lessened.

A budget plan of this character may or may not be all that any organization needs. It provides for a statement of operating plans for the year and for monthly comparisons between actual and estimated figures. At least the plan illustrates the whole principle of budget control which quite frequently has been made so much of a mystery.

## Fraud Affecting the Assets

FRAUD in accounts is no new subject. Practicing accountants have been coping with the appropriative inclinations of abnormal individuals in business for years. Book-writers have discussed the subject at great length and from many angles. However, the frequency with which fraud cases now are appearing, and the relation which the matter has to the practicing accountant and his clients, seem to justify some further consideration of the subject.

Fraud relating to the assets usually results in either overstatement or understatement thereof. The motive for overstatement is to inflate values, thereby increasing the surplus for the purpose of gaining favorable credit consideration, or deriving illegitimate gain on the refinancing of a business enterprise or on the sale of the assets pertaining thereto. The benefit in cases of the latter kind accrues to one or more principals involved as individuals in the capital transaction.

The motive for understatement is to conceal misappropriations of assets. The benefit in instances of this character is derived as a rule by some subordinate employe, occasionally in collusion with other employes or with confederates outside of the organization.

The officers of a certain corporation overvalued the inventories, thereby swelling the surplus, improving the current position, and inducing the banks to extend credit which otherwise probably would not have been extended. An officer of another corporation caused the quantities in the inventory to be increased without warrant, thereby inflating the inventories, and as a result received more new shares in a refinancing and exchange scheme than he was justly entitled to receive. The net assets of one corporation were sold to a purchaser for cash and shares in another corporation. The inventories were grossly overvalued by increasing both quantities and prices on the inventory sheets.

Overstatement of assets affects the profits or the surplus. Profits or surplus are overstated in an amount equal to the inflation of the assets. There would be no point in overstating one asset at the expense of another; nor would any benefit be derived from overstating the liabilities in an amount equal to the increase in the value of the assets.

Understatement of assets is a device to conceal shortages therein. An understatement of one asset may be accompanied by understatement of liabilities, reserves, or surplus, or by overstatement of some other asset. Tracing back through surplus, the understatement may be found to have originated in an understatement of income or overstatement of expense.

Little difficulty is found in detecting what are known as "open" shortages, which involve neither overstatement nor understatement. The wherewithal to satisfy the requirements of the balance at a given date simply is absent, or deficient in amount. While there are various devices used to misrepresent the substance offered in satisfaction of such requirements, these devices are easily penetrated and the misrepresentations quickly exposed. A custodian who is short and has not falsified the records stands little chance of escaping detection in case of verification of the balance with which he is charged.

The cases which offer difficulty in the matter of detecting shortages are those in which the shortage is concealed by misrepresentation affecting transactions which have occurred prior to the date of the accounting. Misrepresentation may consist of false entry of a transaction itself, of failure to enter a transaction, or of manipulation of records underlying the general ledger for the purpose of concealing an irregularity which otherwise would result in an open shortage.

Overstatement of assets usually is conceded to be easier of detection as a practical matter than understatement. Overstatement usually should be detected by verification of balances at a given date, even though an attempt has been made to manipulate the general ledger accounts showing such balances. Understatement, while theoretically as easy of detection, requires verification of transactions, and their entry in the detail records, together with verification of the mathematical accuracy of such records. Practically, the verifications of transactions and of the accuracy of the records frequently are precluded by limitations of time and expense.

Overstatement of assets usually should be detected by a balance sheet verification or a balance sheet audit as it often is called. In accordance with the general concept of a balance sheet verification, the scrutiny of transactions during a period prior to the balance sheet date is not contemplated. Therefore, a balance sheet verification may not be relied upon to detect understatement. In a word, nothing short of a general audit may be expected to detect the understatement of assets whether such understatement is designed to conceal fraud or merely is the result of carelessness or of errors in principle.

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## Book Review

Boomer, Lucius M. *Hotel Management.* (New York, Harper & Brothers, 1925. 486 p.)

Numerous articles have appeared dealing with various phases of the hotel business and certain of its problems, but this book, as a study of the science of hotel management as a whole, is a pioneer. It has been