

Business Booming for Forensic Accountants Demand Rising for Those Who Can Untangle Knots



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Brandlin: Untangling knots made of numbers.

By KATE BERRY

Staff Reporter

JEFFREY Brandlin had spent weeks in the offices of **A&J Cheese Co.**, each day poring over financial statements to figure out what had happened to tens of millions of dollars.

The Upland-based distributor of Parmesan cheese had defaulted on more than \$57 million in bank loans and Brandlin, a forensic accountant, was hired by the company's lenders to sort out the numbers – specifically how to account for a doubling of revenues over a three-year period.

That jump, to \$250 million, initially got lenders interested and allowed the company to borrow against the inflated receivables and inventory. Publicly held **Suprema Specialties Inc.**, which investigators say worked in concert with A&J, did much the same thing.

But how? After almost daily prodding, Brandlin finally got some help from Jack Gaglio, A&J's chief executive. Gaglio, concerned that his office was bugged, took Brandlin outside the building and proceeded to make four circles in the dirt – each one representing one of four fictitious companies – and then a series of arrows connecting them with both A&J and Suprema. The process, sometimes known as “round-tripping,” helps explain a Ponzi scheme that inflated sales of two companies without any cheese every being bought or sold.

“He had a 6th grade education and a rags-to-riches story, and he lived a very high lifestyle, which was the first tip-off to me,” said Brandlin in recalling Gaglio. “Issuing fake invoices obviously was much easier than shipping cheese. If the company had doubled the

amount of cheese it sold, there would have been a caravan of trucks coming out of warehouses to distribute the cheese.”

Such definitive moments don't happen all the time for the growing legion of forensic accountants, but as cases of corporate skullduggery are increasingly probed, these digital sleuths have kept busy, whether it's uncovering white-collar fraud or double-checking the work of outside auditors.

“There's been a tenfold increase in business,” said J. DuRoss O'Bryan, managing director in Los Angeles at **Alix Partners**, the corporate turnaround firm that did forensic accounting work on **HealthSouth Corp.**, **HomeStore Inc.**, **Mattel Inc.** and **Worldcom**, now **MCI Inc.**

Enron aftershock

With stricter rules and higher standards, there is more pressure on managers, corporate boards, audit committees and creditors to root out wrongdoing. Many boutique firms have picked up accountants that fled Arthur Andersen and the remaining Big Four firms.

“It's a function of Enron, and of the SEC, and of companies themselves being much more careful about how they report things, and much more willing to investigate,” O'Bryan said.

In March, Gaglio pleaded guilty to conspiracy and securities fraud charges and is helping prosecutors in a bid for leniency. He faces up to 15 years in prison, but has been released on \$1 million bond. Gaglio also settled a lawsuit filed by the Securities and Exchange Commission without admitting or denying liability. Suprema filed for bankruptcy in 2002 after a large number of allegedly false sales transactions were discovered. (Gaglio's attorney, Mitchell Gaswirth, would not comment.)

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Brandlin, who says he frequently turns over potential evidence to authorities, gets a bit frustrated about the government's limited resources in investigating fraud. “If a robber walks into a bank with a gun and steals \$500, he'll go to jail,” he said. “But if a guy walks up four flights of stairs to a loan office and files fictitious documents to borrow \$20 million, you can't get a prosecutor's attention.”

Forensic accountants do not certify financial statements; that's the role of outside auditors. Instead, they work with auditors and company managers to verify financial records, doing the “pick-and-shovel”

work of accounts receivables, inventories and assets.

As in the A&J case, they are typically hired by banks or private equity firms concerned about an investment or a loan going south. "Usually what happens is a bank calls up and says to get out to a company and 'find out what happened to our collateral,'" said Brandlin.

Forensic accountants charge from \$250 to \$650 an hour, depending on the complexity of the work. Typically, they set up an office within the company, and interview dozens of people, from employees to vendors to clients. In cases where documents have been shredded, forensic accountants can sometimes discover evidence on computers.

Much of the work involves tracking invoices, checking cash flow and looking for related-party transactions in which one company sells a product to another company but actually share the same owner.

Often, a related-party transaction is a sophisticated way to skim money from a company by creating fake invoices, and buying a check-endorsement stamp with the name of a fake company to make the fraud look legitimate. "Everyone has a rationalization for why they commit fraud," said David Nolte, principal of **Fulcrum Financial Inquiry LLP** in Los Angeles.

Among forensic accountants, competition for new business can be stiff. Chief financial officers and controllers often put their audits out to bid for the lowest price, a practice that won't detect made-up receivables or inventory.

"If you have a company with \$185 million in inventory, you have to find out whether the stuff actually exists," said Brandlin. "It can't be a pervasive fraud and the auditor might not be culpable."

Tracking inventory

Brandlin has worked on a variety of high-profile cases, including **Allou Healthcare**, whose top officers allegedly faked profits and orchestrated a fire at a Brooklyn warehouse to try to collect \$100 million in insurance. Five executives at the bankrupt firm were indicted last year.

In another case, the former chief executive of **American Tissue Inc.**, a maker of paper products, was convicted in April of conspiring to commit a \$300 million bank and securities fraud.

David Ostrove, an attorney and accountant at **Ostrove Krantz & Associates**, said forensic accountants are in demand because of an increase in accounting malpractice lawsuits.

"It's a lucrative and growing field," said Ostrove, author of "Analyzing Financial Statements After Enron." "Because of the accounting scandals and the phony financial statements, everybody has decided to sue their accountants, and juries have been found more likely to hold accountants responsible."

Forensic accountants also are in demand among small business owners who typically haven't the resources or the time to investigate themselves.



Nolte: 'Everyone has a rationalization' for fraud.

"There are lots of cases where people are stealing on receipts, on the money coming in, or even writing a check to a phony vendor and issuing a fake invoice," said Nolte. "Then we try to find the missing money."



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