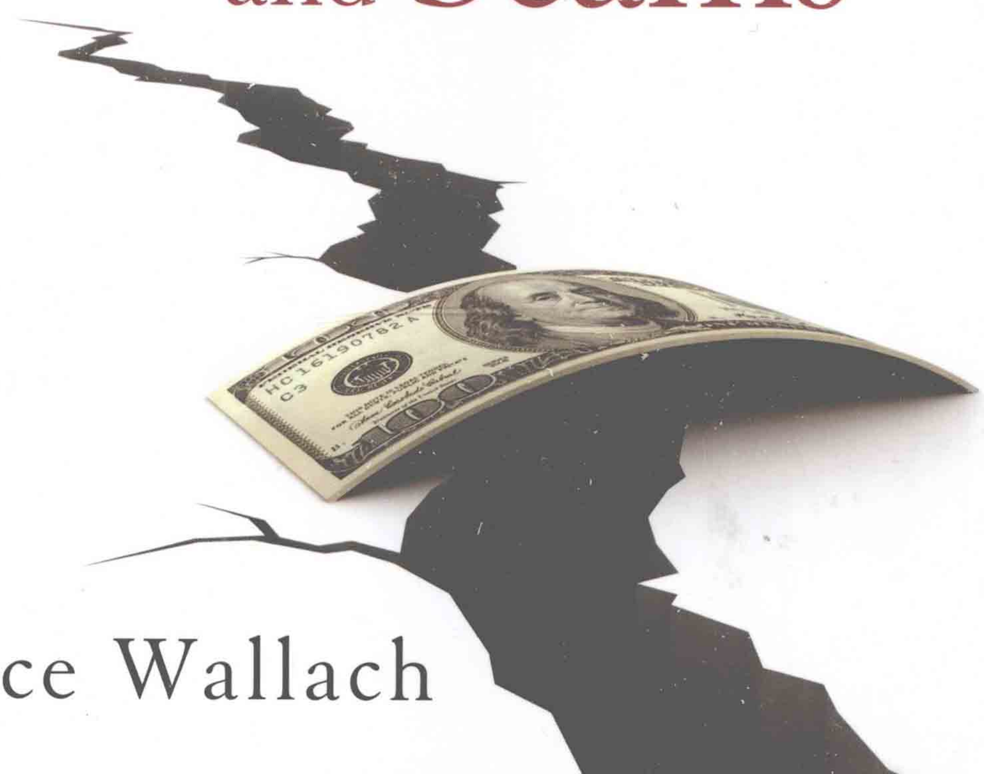
Protecting Clients from Fraud, Incompetence and Scams



Lance Wallach

Acknowledgments

I wish to express my sincere thanks to everyone who contributed to the creation of this book. An "instructional" tome of this nature, by design, relies, from the moment of inception to the last run off the presses, on the advice and input of highly qualified experts. Although many have contributed their expertise in various forms and fashions, I would be remiss if I did not single out and acknowledge the contributions of some people in particular.

Mark Boehm, MBA, CWPP™, was instrumental in pulling this book together. His contributions in terms of content were outstanding, and his editorial commentary improved the flow and delivery of information tremendously. His expertise was invaluable.

Mr. Boehm received his Bachelor of Science (BS) degree from Cornell University School of Agriculture and Life Sciences, and Master of Business Administration (MBA) degree from Southern Methodist University. He is a principal with Alpha Wealth Management, a boutique financial services firm providing asset protection, tax reduction, and advanced financial planning strategies for high-net-worth clientele. Mr. Boehm serves as an expert consultant on all things life insurance related—planning techniques, life settlements (retail and institutional), and captive insurance.

Thank you, Mark, for all your help and input.

Carl Allen III's input regarding forensic accounting investigation was key. Carl is the owner of Allen Financial Services,

LLC. He is a graduate of North Carolina State University (BS Mathematics, 1972) and Durham Technical Community College (AAS Accounting, 1976). Mr. Allen is currently a member of the Association of Certified Fraud Examiners, the National Association of Tax Professionals, and the National Society of Tax Professionals. He is a volunteer representative for the NC State University Student Aid Association, and provides support and resources for Elon University students pursuing opportunities through their career center.

Mr. Allen has served in various financial management positions over the past 30 years with companies in the insurance and construction industries. He provides accounting and technical support for small businesses in the areas of: fraud investigations, interim accounting management support, accounting and project consulting, and income tax preparation and planning.

Thanks, Carl.

Aaron Skloff, AIF, CFA, MBA, provided much of the content for this book. Let me outline for you briefly a few of his accomplishments so you can understand the level of advice you're about to receive.

Mr. Skloff received a Bachelor of Science (BS) degree in accounting from Pennsylvania State University's Smeal College of Business and Master of Business Administration (MBA) degree in finance from New York University's Stern School of Business. He is a Chartered Financial Analyst (CFA), a member of the CFA Institute (formerly the Association for Investment Management and Research) and an Accredited Investment Fiduciary (AIF).

He has taught finance courses through Rutgers University. His equity research reports have been published on the two largest financial research databases, First Call and Multex. During the course of his professional career, he has been cited by the *Associated Press, BusinessWeek, Dow Jones, Fortune,* *Princeton Business Journal, Reuters, Wall Street Journal,* and other news organizations.

Mr. Skloff is CEO of Skloff Financial Group, a register investment advisor firm based in Berkeley Heights, New Jersey. The firm specializes in financial planning, investment management, and risk management for individuals and families and group benefit for employers.

Thank you, Aaron.

I'd also like to gratefully extend my sincere appreciation to all the people from John Wiley & Sons who were instrumental in bringing this book to press.

Lance Wallach

Introduction

Every Accountant and Attorney Should Read This Book

Honey, I forgot to duck . . .

—World Heavyweight Champion Jack Dempsey after losing the heavyweight title to Gene Tunney in 1926

For better or worse, it is the year of Bernie Madoff. His investment firm, a hollow Trojan Horse parked on Wall Street, was emblematic of a financial system that strangled itself on opportunistic lies about complexity and global markets.

Complexity in volatile trading markets certainly exists, but too often the fund packaging nomenclature was used to shield mediocre and abysmally poor fund managers from the results of their shenanigans, operating as a buffer between the managers and their clients. Arias for what used to be called merely "trading" became surgery on financial instruments and rebundled new packages.

The problem, as one analyst said, was that these people claimed sophistication but they had no artistry.

In the arts and finance, people follow stars.

Once Bernard L. Madoff's mysterious but outperforming methodology gained public traction, the volume of investors lined up to suck on the teat of putative success and was the line around the block in posh zip codes. Business owner–investors might have camped out in line, too, but they needed to be at work in the morning to face the constant purveyors of erosion to their businesses.

Madoff Investment Securities garnered much privately held largesse. And yet, believe it or not, there may be worse players out there than "the Bernster." Corporate workers know their 401(k)s or pension incentive plans are faring to the bad side lately.

If workers want to feel better, they should look west—to California to be exact. The Sunshine State holds publicly funded asset pension trusts as large as a roundup of third-world debtor nations. Guess how much they've lost recently? If you're a public employee, you need to know, and you need to know why. If you're a business owner, you also need to know how and why.

The key margin is the players between corporate and public entities. That would be you—small- and mid-size business owner–investors. As if you're not burdened enough, no longer can you afford to let a rising stock market raise all boats—drownings, sharks, and icebergs have already been sighted.

You cannot afford to calculate mystery black box schemes perpetrated by former NASDQ Chairs—one Bernard Madoff to be exact. Due diligence in all phases of business operations seems in order. This diligence will require no sleep for the next, oh, 10 to 20 years.

Not really, if you can answer one basic question:

Why don't "experts" read the IRS code like a medical school manual of surgery?

Answer(s):

First, there aren't that many "experts," and those that are seek to keep a low profile (in comparison to TV talking heads who make their money from boob tube salaries, not real-world contingencies), because they have had a loyal clientele for decades. The sad news is—they don't need you; in fact, they probably couldn't fit you into their mad schedule.

Second, capitalism does share in archetypes that fly below the radar (because they're legal strategies) and rewards due diligence with annual gains rather than one-time overlarge payouts (the latter used to be called gambling).

Third, a team approach to business investing, utilizing a tax strategist, insurance—legal specialist and financial planner, who actually talk to and meet one another—will, in the long run, outperform the one-shot wonders.

In this book, we provide you the blueprint. You need to take the necessary actions. Business owner–investors are the middle layer between public service–government organizations and multinational corporations. You are the serious music the U.S. dream and economy thrive upon.

I would say you need to learn how to box.

Contents

CHAPTER 1

Meltdown

Muhammad Ali: Superman don't need no seat belt.
Flight Attendant: Superman don't need no plane, neither.

The U.S. financial system meltdown has grimly scythed decades of accumulated business profit, investment, and personal wealth. As we have seen, investors undervalued their own rationality and overvalued chaotic wealth management schemes masquerading as complex asset management in a global economy. Investors dumped business earnings, pension assets, and personal funds into investment portfolios without due diligence as to the logic and structural soundness of those investments and their strategic economic orientation.

Counterintuitively, many wealthy investors and business owners took leaps of faith with hard-won assets into complex investment schemes they didn't understand because returns were bountiful. The hard work processes by which investors grew their businesses or their wealth did not seem to apply to strategically marketed programs devised by Wall Street wizards. "The wizards must be smarter and more inventive" was the mantra. It was an era where not paying attention yielded robust earnings.

The Party's Over

The charlatans have now been revealed and returning to earth awash in lost assets has been a hard lesson learned for many business and personal investors. Fear of any kind of strategy beyond the most basic principles of accounting math has turned financial markets into rigid, ossified institutions. Credit is tight; doubt is rampant. But fear need not overtake common sense. If one is strategically poised to act, there are methods to reap opportunities even within the constant inhalation of a bad news economy.

There are ways to maximize wealth assets through sound tax strategies aimed at reducing exposure to IRS audits, while freeing liquidity for further investment income growth. Part of the picture is understanding what the U.S. government has and has not done in the financial sector.

The U.S. government failed to regulate its own legislative loosening of the credit and investment markets. The government allowed financial businesses that previously dealt in single issue items, such as credit allocation (banks), insurance (insurance companies), and tax protection (accounting firms) to become full-service investment/banking/insurance hundred-headed hydras. With the ability to manipulate different asset classes, many of these businesses grew astronomically by forging new markets out of fringe niches and clients they previously would not have pursued.

Much of the growth was built on Ponzi-type schemes of trading one asset class for another, rebundling (while claiming it was an asset protection maneuver), and charging transaction and management fees for transferring and translating assets into different holding tanks. Ethical portfolio diversity became a joke.

Forensic auditors will spend years trying to unravel the origination of lost portfolios and their mutation into worthless products that propped up marketing schemes.

We All Know the Result

Because the government was involved in allowing multipurpose financial institutions to pursue growth by any means necessary, the government now stands confused, dazed, and unable to act under the fallout from the variety and volume of reckless financial transactions it helped perpetuate. In fact, it is throwing more money into the hollow house called Wall Street, assuming that the perpetrators will suddenly ethically encumber themselves and fix the problem.

Meanwhile, the Security and Exchange Commission (SEC), the so-called regulatory agency of the U.S. financial system, is like a lost orphan, its budget miniscule in comparison to the largesse tossed to the big dog bankers and their pals. Shouldn't the budget allocation be the opposite until we have reviewed and identified the malfeasance that brought down the system?

There is another looming storm on the horizon that could swamp any economic lifeboats sent out into the water by the government. There is the potential for a catastrophic failure of retirement funds in the United States, affecting nearly one-third of the pension plans existent. With baby boomers set to retire in massive numbers, such a failure would further erode a weak, destabilized economy.

In 2006 Congress passed the Pension Protection Act, mandating that companies with defined benefit pension programs be fully funded, as measured by the ability to pay out money to all retirees should the latter decide to withdraw their accrued assets. Of the 500 largest U.S. companies, more than 200 do not meet the Pension Protection Act standard in 2009.

Standard & Poor's 1500 Index of corporations reveals how dire the situation has become: The Index corporations moved from a $60 billion pension plan surplus at the end of 2007 to $409 billion deficit before the end of 2008. Defined benefit pensions (usually, where an employee payroll deduction is matched by the company into the employee's retirement fund) at these companies are part of a potential nightmare scenario even in good economic times, and we are entering an undefined period of economic uncertainty and groping in the dark.

When revenues decline in an economic crunch, payroll must be met at salaries that haven't declined. In the worst situation, a company may have to decide between meeting payroll and matching payroll-defined pension requirements. Corporate pension funds are troubled and clearly face the problem of underfunding. Many of the corporate pension funds invest their money conservatively. There are, however, a group of pension fund managers who have not invested conservatively or wisely and they are the first wave of a larger pension fund tsunami that could catapult the U.S. economy into a stunning freefall.

The snowball rolls downhill: jobs are cut, stocks consistently trend downward, reducing a company's investment stream, destabilizing the stock market and the company's ability to remain productive or even solvent.

Public pension funds and federal retirement accounts hold approximately $3.5 trillion in their accounts. There is another $1 trillion in unionized corporate workers who are part of the management team deciding fund investments. Together, these funded retirement vehicles cover approximately 27 million Americans and account for more than 30 percent of the U.S. retirement pension fund system. A failure of 30 percent of the system would be catastrophic to United States and international markets and to the personal retirement benefits of the invested potential pensioners.

Grim Statistics

The bad news is that 30 percent was at risk before the current financial meltdown. The worse news is some pensions are close to defaulting without cash infusions that would have to come