The best bits by FAR

Welcome to the first issue of FAR Consulting's quarterly newsletter.

FAR Consulting launched on 3 January 2006 and has a growing reputation for providing high quality forensic accounting advice at market leading rates. Our team are all experienced ex "Big 4" forensic specialists working remotely from offices in Manchester, Liverpool and Birmingham, or from client sites and other locations wherever the need arises.

Uniquely within the UK, in addition to providing the "traditional" expert witness service, FAR Consulting provides "in-house" forensic consulting services to a range of lawyers, insurers, insurance brokers and corporates direct. Our recent assignments include:

- acting as independent expert for six high street retailers bringing loss of profits claims against their landlord when a retail park was forced to close due to safety issues;
- providing in-house advice to the sellers of a business following acompletion accounts dispute that evolved into an alleged £6 million breach of warranty claim;
- acting as independent expert for a defendant in an alleged £34 million VAT Carousel Fraud;
- acting as a shadow expert, providing assistance to a Respondent in a multimillion divorce case; and
- acting in-house for insurers and their panel solicitors, providing advice regarding loss of earnings, pension and dependency claims, enabling them to settle claims for less, quickly and cost efficiently.

We hope you will find the articles included both interesting and informative, as we aim to keep you updated on recent events and provide you with news and information that is relevant to you. We would welcome any contributions or comments you may have.

In this first issue we consider fraud allegations from two different perspectives. First, we consider companies attitudes to mediation in cases where fraud is suspected. Secondly, in criminal cases, we consider how the evidence reviewed by an expert accountant may help and hinder both the Prosecution and the Defence.

Finally, with a high profile arbitration hearing scheduled for the 18th June, we consider how much West Ham's purchase of Carlos Tevez (coupled with results over 38 games and an FA Premier League ruling!) has potentially cost Sheffield United.

If you would like to discuss any matters raised in these articles in greater depth, or for more information on how FAR can provide forensic accounting assistance to you, we would be delighted to hear from you.

Yours sincerely

Greg Lacey, Managing Director

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Mediation and the "f" word By Phil Southall

Mediation is commonly used to help settle commercial disputes, but in cases where there are allegations of fraud, there can often be a reluctance to mediate. Phil Southall considers the implications of this trend for both parties and why mediation could still be an appropriate option.

Pursuing a case to trial is a lengthy and costly process. Although legal fees can be significant, the continued distraction of litigation preventing management from running the business or dictating an individual's life can also represent a significant intangible cost to the parties involved. There can also be major uncertainties regarding the potential outcome that may be achieved at trial and the factors which affect this, encompassed by the term "litigation risk".

Why is fraud different?

Whilst the high costs and significant uncertainty surrounding trials has led to mediation, or other alternative dispute resolution processes, being a popular choice to help resolve disputes, the use of mediation is much less prevalent in fraud cases. It appears that whilst entities adopt a commercial approach in most types of litigation, many do not adopt the same approach in cases involving fraud, which is surprising considering:

- the costs of pursuing/defending allegations of fraud to trial are likely to be greater relative to the amount in dispute/alleged fraudulent benefit, as the complexity of the fraud often means that the costs of analysing potentially complicated and/ or conflicting evidence to the standard necessary to present a credible case in court can quickly and easily mount up;

- the potential outcomes at a fraud trial, particularly criminal cases, are often far more extreme than in most commercial litigation cases, for example, one party may be facing a lengthy prison sentence if found guilty. However, even if found culpable of a fraudulent breach of contract or warranty at a civil trial, the company or individual may struggle to find a job, or win new contracts, ever again. This could easily bankrupt a business or affect an individual's whole livelihood, which is clearly more extreme than the outcome in most litigation cases; and

- there is often increased uncertainty surrounding these potential outcomes at trial, particularly in cases where there is complex evidence and witness cross-examination will be critical, as this simply cannot be predicted in advance.

Reputational damage

Many companies would rather keep suspected frauds, particularly employee frauds, out of the public domain, and this can govern the strategy that it chooses to adopt. Indeed, some companies may not wish to take any action due to the potential reputational damage of a failed trial, whilst other entities consider that all fraud allegations should be pursued to trial no matter what the cost. However, in the majority, if not all fraud cases, mediation may provide a means of resolution satisfying both parties objectives.

First, mediation can be undertaken at any time in the litigation process, and with appropriate confidentiality agreements/agreed statements the outcome can be kept out of the public domain, potentially benefiting both parties. It is not necessary to prepare evidence to the standard required at a trial; simply the indication that this standard could be met at trial may be persuasive enough to facilitate a settlement. This not only saves significant expenditure on legal fees, but brings forward the date at which any potential recovery may be received.

Furthermore, for the accused there is no possibility of going to prison as a result of a mediation! Therefore, mediation is a far less risky environment for both parties. Undertaken at the right time and with a competent mediator, despite the underlying distrust between the parties, it should be possible to negotiate a settlement that is acceptable to both parties, with approximately eight out of ten mediations being successful on the day or shortly thereafter. Indeed, I have personally been involved in successful mediations involving companies suspecting:

- that fraudulent results formed the basis of the price for its latest acquisition;

- over-invoicing by subcontractors, based upon fraudulent time recording;

- supplier collusion with employees; and

- employee theft.

There are also a number of well publicized cases such as that of the mobile phone trader acquitted of VAT fraud in 2005, who subsequently paid in excess of £18 million to the Asset Recovery Agency and the Criminal Assets Bureau.

Flexibility

The flexibility that mediation can provide is perhaps best illustrated by way of a simple example:

A company has been advised that to pursue a suspected fraudulent employee to trial will cost £150,000. While the company suspects that the employee has been colluding with a supplier, and has been overpaying for contracts from which the employee has received "kick-backs" to the value of £1 million, the evidence to support this value is far from conclusive. However, certain employee bank accounts have been identified into which £250,000 has been paid, and the source of some of this income is unknown.

The company is advised that due to the uncertainties surrounding the evidence there is only a 15% chance of proving that the fraudster had benefited by the £1 million suspected, but a 40% chance of successfully proving a £250,000 fraud. The commercial question therefore becomes does the company wish to pay £150,000 for:

- a 15% chance of recovering £1 million (plus a contribution towards its costs from the defendant);
- a 40% chance of recovering £250,000 (plus a contribution towards its costs); but
- a 45% chance of being unsuccessful, in which case the company would have to pay a further £100,000 by way of contribution to the defendant's costs.

The answer will of course depend on the decision maker's attitude to risk. A purely commercial decision would ignore points of principle such as public perception of the company's attitude to fraudulent employees, which a company may consider to be too important.

Additionally, it is also important to consider other factors outside of this particular dispute. For example, what if this same company also has the option to purchase a machine for £125,000 that will generate a risk free ongoing profit for a number of years, but cannot afford both the machine and litigation? What should the company do? If successful at trial the return may be very significant, but the company is three more times likely to lose than recover £1 million at trial, and could the company afford to lose and pay more money? By not pursuing the fraudster the company is effectively giving up its chance of recovering in excess of £1 million, and it therefore may be reluctant to do so, in which case mediation may provide an ideal solution that addresses all of the above issues.

It may well be possible to have a successful mediation after incurring only £25,000 of legal spend, which would also enable the company to purchase the additional machine. If so, clearly, this is a cheaper, quicker alternative than pursuing a matter to trial, which can provide:

- confidentiality to both parties, thus protecting future reputations;

- the opportunity for the company to make a timely recovery; and

- the individual to re-imburse the employer, in return for which further penalties, both legal and reputational may be avoided.

However If public perception is also important it may be possible to also agree a statement that could be issued stating that this matter has been dealt with legally and/or funds have been recovered, thus sending out the message that the company will not tolerate such behaviour.

Principles

When fraud is concerned entities can be reluctant to consider alternative approaches to resolving the issues commercially due to overriding objectives of principle. However, adhering to principles can be costly, and ultimately unsuccessful, whereas by lowering the stakes for both parties it is possible that an acceptable, though perhaps not ideal, settlement can be reached. But that said, when is it ever ideal to have to deal with an allegation of fraud?

Phil specialises in advising on appropriate settlement strategies. He has significant experience of representing his clients on numerous occasions in settlement meetings, mediations and attending court.

Why Carlos Tevez has cost Sheffield United more than he cost West Ham... By Greg Lacey

The FA Premier League failed to deduct points from West Ham despite finding them guilty of acting improperly and withholding vital documentation over the ownership of Carlos Tevez (and Javier Mascherano) because "a deduction of points would not be proportionate.(it) would have consigned the club to certain relegation." Rightly or wrongly this decision, coupled with subsequent results, effectively relegated Sheffield United. Greg Lacey considers the full cost of Carlos Tevez and the FA's decision to both clubs from a forensic accountant's perspective.

In terms of actual cash spent to date in the acquisition of Carlos Tevez by West Ham, Sheffield United, strictly speaking, has not spent a single penny. In contrast, West Ham has spent undisclosed acquisition costs (including agent's fees) and approximately £6.5 million, comprising:

- £5.5 million, the widely reported record fine imposed by the League Commission as punishment to West Ham for being found guilty; and
- an estimated £1 million in player wages, in line with the Premiership average.

However, both teams will also have incurred legal fees in relation to the purchase of Carlos Tevez. West Ham in preparing for an FA hearing, and Sheffield United in filing arbitration proceedings against the FA Premier League over its decision not to deduct points from West Ham. Even if Sheffield United is successful in its action, it will be left with significant unrecoverable legal costs and if further legal action becomes necessary, this will only serve to increase its costs further.

In one sense the Premier League was right when using proportionality to justify its decision, clearly had three points been deducted from West Ham the club would have been relegated. By instead imposing a record £5.5 million fine the FA acknowledged that Premiership status is worth far more than this. This is something that Sheffield United will no doubt find out next season unless its Premiership status is re-instated following the arbitration hearing that is scheduled for 18 June 2007. The likely financial impact is considered in more detail below.

Prize money and tv revenue

First, by finishing one place lower in the Premier League than would have been the case had West Ham been docked three points, Sheffield United has lost £0.5 million in prize money.

Secondly, the club finishing bottom in next year's Premiership will receive £30 million from television revenue, with higher placed teams receiving incrementally more. Therefore Sheffield United could have expected at least £30 million from this source. However, as things stand, Sheffield United will receive:

- £11 million by way of parachute payment; and
- a maximum of £1 million of television revenue and prize money, even if it wins the Championship.

In terms of next season's revenue alone, the cost of Premiership status to Sheffield United will be at least £18 million.

Loss of gate receipts

Sheffield United has already reduced season ticket prices for the forthcoming season, leading to a reduction in gate receipts even if attendances remained constant. However, as reducing prices appears to be a widespread trend in any event, even with some Premiership clubs in the north of England, let us assume that this loss is not as a result of relegation.

However, Sheffield United's average home attendance last season was 30,684, compared to 23,650 when it was last in the Championship. Assuming a similar fall in attendances this time around, the loss to the club could be at least £2.9 million ((30,684 - 23,650) x £419 - the average price of a season ticket).

Furthermore, Sheffield United has offered to refund half of the cost of season tickets to 25,000 if it is successful in returning to top flight football at the first attempt. This may mean that attendances do not fall to the levels anticipated in the previous paragraph, but could ultimately cost the club around £5.25 million (25,000 x £210).

Had the club not been relegated then obviously this offer would not have been made. Whether this offer, legally speaking might fall foul of the obligation to mitigate, it is nevertheless interesting to note the potential cost of the offer to Sheffield United is similar to the fine imposed on West Ham.

Other potential losses

There would also be other potential losses, which cannot be accurately quantified without further information, these include:

- loss of sponsorship revenue;
- loss of complementary sales, resulting from lower attendances, including:
  - on match days - parking, sales of paraphernalia, pies, pints and programmes; and
  - shirt sales and other merchandising; and
- losses from the distress sale of expensive and "want-away" players.

Cost savings

However, there will also be some cost savings as a result of Sheffield United's relegation. Again these are difficult to quantify without further information, but include:

- savings in players wages - both from cheaper wages for replacement players, but also due to contractual reductions in existing players' salaries;
- whether there will be a saving in manager's wages will rather depend on the deal new manager Bryan Robson has done for himself; and
- reduced match-day support cost, such as programme sellers, stewards, pie and pint sellers, and also potentially security/policing costs.

Let us say for simplicity, that these current unquantifiable costs and savings are equal and opposite, then they can be ignored for the purpose of a calculation. Finishing 18th in the Premiership has therefore cost Sheffield United in excess of £26.65 million. This significant loss was reflected in market sentiment, the first day of trading following the conclusion of the Premiership saw £13.9 million wiped off the value of Sheffield United's shares.

Whether or not the FA was right to deduct points from West Ham, Sheffield United seem set to suffer a loss almost five times greater than the value of the fine imposed on West Ham. Had West Ham been relegated the club would at least have been consoled in being able to dispose of one asset, one Carlos Tevez, for around £25 million (per Tevez's own valuation). This would at least have gone some way to offsetting the financial black hole that Premiership relegation imposes.

Beware the "soft underbelly" in fraud cases By Greg Lacey

It is often the case that when instructed as an expert accountant for the Defence in an alleged fraud case I will be directed to only investigate specific aspects of the case, typically those identified by the Prosecution as being supportive of its case, in the hope that a specific piece of evidence appears to support the Defendant's version of events.

However, when reviewing a specific issue an expert accountant often has to review wider financial information in order to understand the context to any opinion he might form. As a result of this, the accountant obtains insight into rather more than the isolated issue he has been specifically asked to address by the Defence team. It is here that secondary evidence can come to light which can compromise other areas of the Defendant's case. I think of the wider financial information in fraud cases as the "soft underbelly" – without a full understanding of which there is always the risk of overlooking something relevant to the case.

By way of an example, in an alleged MTIC fraud, I was instructed to review HMRC's reconstruction of a set of accounts. Their reconstructed figures appeared to show a gross loss of some £1.0 million in monetary terms – a helpful conclusion in the context of trying to portray the trader as being involved in a carousel fraud. However, the internal accountant instructed by HMRC had included the purchase of a consignment of computer chips, but had failed to take account of the value of the chips within closing stock (in itself unusual for a trader allegedly involved in a carousel fraud). Although a box of CPUs is small in size, it had a value of £2 million, which, if adjusted for in the reconstructed accounts would imply a gross margin of £1 million instead of the apparent £1 million gross loss.

So far, so good. Unfortunately, during the course of our work we identified a series of other transactions/issues which although not instructed to comment upon, certainly fell within an expert accountant's area of expertise. These issues included the making of third party payments, third party loan funding which appeared interest free and had no repayment term – in fact had no documentation at all to support it, and, perhaps more subtly, the accounting records themselves.

Whilst the VAT returns and the VAT records were up to date and perfectly maintained, these records almost stood alone and were completely independent of the banking records and the underlying accounting records which had barely been maintained at all. The very fact that the accounts had needed to be reconstructed at all spoke volumes with regard to how poor the general bookkeeping had been. This may not have been obvious to a non accountant, but given the exactness with which the VAT records had been maintained, it just didn't make sense from a record keeping point of view not to maintain the other accounting records to the same standard. In short, had the business traded to a period end, there would have been an almighty headache when trying to produce year end accounts. Accounts which, but for minimal effort, could have been straightforward to produce given that the VAT records had been prepared in a meticulous manner.

If asked about this, based on my experience in general practice, my conclusion would have had to have been that the accounting records were not really consistent with what you might expect to see if someone had been truly interested in the day to day performance of the business, let alone interested in complying with the record keeping requirements of the Companies Act.

Once all these secondary points were brought to the Defence's attention, it became clear that evidence that had at first appeared potentially helpful actually had a rather bleaker angle to it. However, things were probably not as bleak as they might otherwise have been had it been left until cross examination for these other points to come out. After all, there are ways and means of introducing accounting evidence without necessarily calling an accountant as an expert witness.

This raises a couple of further points worth bearing in mind, where exposing the "soft underbelly" can be painful but overall is probably helpful to the case because it enables the following:

- to fully understand the risk of producing expert accounting evidence;
- in identifying points that up until now have not been put forward by the Prosecution, but which may well be raised later in Court. To be forewarned etc; and
- to help establish a better informed overall picture when it comes to reviewing a pleading.

Occasionally, just occasionally, an experienced forensic accountant will identify issues and aspects arising from a review of the wider financial information that will provide support to a Defence team's case that until now had been overlooked, which although particularly subtle, will be no less valid.

To ensure the chances of missing any of these angles, it is probably always worth taking time to discuss a case in outline with a forensic accountant. This should generate ideas and angles which you can then consider and make your initial assessment whether any are worth reviewing further. The only point I would make here is that you don't know unless you check and, ultimately, it is more than likely that it will be in your client's best interests to understand the full extent of the "soft underbelly" come what may.

Greg has been instructed to act in a number of alleged fraud/theft cases and in confiscation proceedings. The company acts for a number of mobile phone traders and has particular expertise in this sector.

FAR Consulting - Key contacts

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Greg, a Chartered Accountant, has specialised in forensic accounting for over ten years. Greg has represented many of his clients at mediations and as an expert witness. He has prepared reports as an expert, a single joint expert or court appointed expert. He has experience of high profile cases involving contract and pricing disputes, completion accounts disputes, product recalls and royalty disputes, gained whilst acting for a number of high profile clients across a broad spectrum of sectors.

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