



HOW FINANCIAL STATEMENTS ARE FALSIFIED

While financial statement fraud is much less common than asset misappropriation, its consequences are typically much more severe. The Association of Certified Fraud Examiner's 2006 Report to the Nation reported a median loss attributable to financial statement fraud of \$2,000,000. The five more common financial statement manipulation schemes, in order of occurrence, are:

Concealed Liabilities

Financial statements are misstated by improperly recording liabilities and/or expenses.

- Significant expenses or liabilities are omitted.
- Revenue based expenses are recorded as capital expenditures. (Falsely increasing net income and total assets.)

Fictitious Revenue

Financial statements are inflated by recording sales that never occurred or by inflating the amounts of actual sales.

- Sales of inventory to phantom customers.
- Invoices show sales of goods to existing customers but the goods are never delivered. Sales are reversed in the next accounting period.

Improper Asset Valuations

Financial statements show fraudulently misstated asset values.

- Obsolete inventory is not written off.
- Accounts receivables are inflated by recording fictitious sales.

Improper Disclosures

Financial statements do not disclose material information in an attempt to mislead users.

- Material contingent liabilities are not disclosed.
- Financial statements fail to disclose that one of the company's largest suppliers is owned by the corporation's president.

Timing Differences

Financial Statements are intentionally misstated by recording revenues in a different accounting period than their corresponding expenses.

- Net income is manipulated by recording sales that occur in December but not recording the corresponding expenses until January of the next year.

Significantly, in 55% of the reported cases more than one method of financial statement fraud was used.

