

The Journal of

LENDING & CREDIT RISK MANAGEMENT



Looking for Fraud in All the Wrong Places

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As the saying goes in the commercial lending industry, "Everyone knows a good loan and everyone knows a bad loan. Successful lending is based on knowing which of those in the middle will turn out right."

Lenders have obvious reasons to be concerned about potentially fraudulent borrowers and certain attention is paid in that regard, such as performing background checks, in deciding whether or not to extend credit. By comparison, hardly any attention is devoted to an equally important area of fraud, which just as regularly leads to default but involves no actual or potential wrongdoing on the part of the borrower.

We are talking about fraud at the level of the use of the credit. If the borrowed funds are to be used to buy a franchise, make sure the franchise is not fraudulent. If the funds are for a corporate acquisition, look into the corporation that is to be acquired with at least the same intensity as the borrower. Think of it as if there are always at least two "borrowers."

Fraud is a different animal—it is not sufficient that lenders know *where* to look, they also must know *how* to look. In that regard, be forewarned that traditional due diligence steps are generally inadequate to the task. For example, when it comes to fraud, it is unwarranted to rely upon a certified financial statement even if prepared by a prominent CPA firm. Standard CPA engagement agreements with audit clients state clearly that the auditors are specifically *not* engaged to discover fraud or defalcation. Similarly, while lawyers provide important protections, that activity is again not the same as that of detecting fraud.

Not only must lenders look below the surface, at a separate and distinct level they must use a looking glass that is specifically designed to see fraud. Lenders will be pleased to know that when engaged in such activities on their behalf, Forensic Accounting Services has found that appropriate scrutiny is welcomed by commercial borrowers, who often pay a fee for the service, since it leads to enhancement of the probability of their success.