

SOLVING THE CASE OF HIDDEN FUNDS



In many financial forensic contexts, such as divorce or fraud investigations, the parties involved may have a financial motivation to conceal assets or income sources. Finding these misappropriated items can be difficult; however, financial experts are trained in investigative techniques* that give them the knowledge and skills to analyze financial records and discover these hidden items.

Preparing for the investigation

Experts often beginning their analyses by reconstructing the subject's financial data. There are two primary approaches used when searching for hidden funds and the financial expert will typically organize the information they gather accordingly. The first is the direct approach; methods under this approach focus on sources of information that directly link the transaction in question to the subject's financial records. Common sources used in this approach include:

- bank statements
- tax documents
- payroll records

- expense reports
- court filings
- real estate and loan documentation
- credit reports

When the hidden asset or funds cannot be directly linked to the subject using the above sources of information, financial experts will use the indirect approach. Methods under this approach depend on circumstantial evidence and imply the subject's use of hidden funds. When using an indirect approach method, the subject's financial records may be unavailable or unreliable. In such a case, the financial expert will utilize third party documentation and public records.

Method(s) to the Madness

Under the indirect approach to finding hidden assets, there are three basic methods used by financial experts. The first method is the asset or net worth method where the financial expert will compare subject's net assets (assets less any debt) at the beginning of the year to those at the end of the year, adding known income and subtracting known expenses. This formula is in the table below:

TOTAL ASSETS

- Liabilities
- = Net Worth
- Prior Year's Net Worth
- = Increase in Net Worth
- + Living Expenses
- = Income (or expenditures)
- Funds from known sources

= Funds from hidden sources

Source: 2021 Fraud Examiners Manual

A result greater than zero indicates that funds from hidden sources exist. This method is most appropriate when the subject is suspected of using hidden funds to purchase assets or pay off debts.

Another method is the expenditures method, where the financial expert will analyze the subject's expenses and look for any discrepancies between their sources of funds (such as, salaries, inheritance, investments, etc.) and their expenditures. The basic formula for this method is expressed as follows:

EXPENDITURES (application of funds)

- Funds from known sources

= Funds from hidden sources

Source: 2021 Fraud Examiners Manual

If the analysis proves that the subject is living beyond their means (expenses exceed total funds), hidden funds exist. This method is best used when the subject is suspected of using illicit funds on expenses such as travel and entertainment.

In some circumstances, a more in-depth analysis may be necessary if the subject is suspected of skimming funds to pay for expenses. In such instances, the bank deposit analysis method is used by financial experts.

The bank deposit analysis method focuses on analyzing the subject's bank statements. This method relies on the assumption that if someone receives money they will either deposit it or spend it. The financial expert begins by calculating deposits to all accounts during the year and then adds cash expenditures to arrive at total receipts for the year. The table below summarizes

the formula for this method:

TOTAL DEPOSITS TO ALL ACCOUNTS

- Transfer and redeposits
- = Net deposits to all accounts
- + Cash expenditures
- = Total receipts from all sources
- Funds from known sources
- = **Funds from hidden sources**

Source: 2021 Fraud Examiners Manual

If total receipts from all sources exceeds funds from known sources, hidden funds exist. This method is particularly useful with cash-intensive businesses.

How to proceed

When it comes to contentious situations such as marital dissolution or other legal proceedings, one or more parties may be motivated to wrongfully hide assets or sources of funds; however, in some cases, assets can be obscured by conventional protection measures without the occurrence of a wrongful act. In either case, a financial professional can help you achieve full and complete disclosure as well as determine the existence of hidden funds.

*The fundamental forensic investigative concepts discussed in this article are consistent with the investigative techniques taught in the 2021 Fraud Examiners Manual, published by the Association of Fraud Examiners; however, the text of this article is presented in the author's own words.

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