How to Avoid the Terrible Pancake Tragedy

Here's what forensic accountants see a lot in the field these days, and almost always there is an accusation of fraud — financial fraud as well as tax fraud.

**THE PLAYERS**

Often, two shareholders are involved. Shareholder A is often the “money” person. He or she has multiple businesses, access to credit, and invariably not all their enterprises are successful and these become a black hole for money.

Partner B is the “expert” — with unique ideas and skill sets such as promising new products or the know-how and equipment to make excellent products. We’ll call him here, a pancake aficionado.

But, he has no cash, and lacks relationships in the pancake business community. He is also a bit unsophisticated financially or accounting-wise.

**THE SET UP**

So now the partners find each other and decide they can help each other. They create the A&B’s partnership entity.

Partner B makes amazing pancakes and partner A stays out of the business but keeps the books and records, managers the payroll and pays all overhead expenses.

Sometimes we see Partner B take care of payroll and operational expenses — to “help out” — but not with full access to the books, bank account, and tax return (beyond the K1 they each get every year).

**THE STING**

The partnership is making money. Partner A needs money for his lavish lifestyle, other failing enterprises or even new enterprises. Partner B meanwhile is mostly kept in the dark, and just keeps those amazing pancake flying off the griddle.

So Partner A starts to siphon money out of the pancake business in a serious way. We see different schemes — taking management fees, diverting income to A’s related entities, pushing expenses from A’s entities to A&B’s pancake enterprise, taking assets and selling them — to name a few. All of these are at the expense of B’s share of the profit, because A is almost always squeezing the net income with his transactions. What’s left for B is enough to pay the two partner salaries, and maybe a small bonus — not the real reward deserved by those amazing pancake making skills… and impressive revenue growth.

**IT COULD HAVE BEEN AVOIDED**

Eventually, partner B wises up, starting to ask questions, wanting to inspect the books and records, questioning the accountant who prepared the tax returns, and wanting more control over revenues and expenses.

That’s when the unfortunate reality is revealed and often Partner B must pay legal and forensic accounting fees to achieve clarity that should have been there all along.

So we, the forensic accountants, get the call at that juncture and we quickly realize that a few steps would have prevented this from happening in the first place. If you are “Partner B” (or before
you become “Partner B”:

1) Have a clear operating agreement and / or MOU.
2) Have a real annual meeting to go over the numbers, ask questions and agree on strategy.
3) Hire a CPA firm, lawyer, and even vendors that are familiar with the fictional “pancake business” They have a valuable sensitivity to a one-sided view from the money partner and can alert the unaware “Partner B” before things get out of hand.

**Bottom line:** In almost any business, the minority share has rights and if trampled upon there will be a day of reckoning.

**White-Collar Crime Fighter source:**
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