

Login

username  
.....

help login

Three Month Free Trial and other subscriptions

Archive

search 🔍

Technical Articles

- Comment
- Latest Articles
- Trusts & Estate Planning
- Asset Protection
- International Tax Planning
- Tax Treaties
- Banking
- Foundations
- Funds
- Hedge Funds and Alternative Investments
- Insurance
- Islamic Finance
- Philanthropy
- Regulation
- Technology
- United Kingdom
- United States of America
- Asia
- Europe
- South America

Jurisdictions

- Antigua
- Austria
- Bahamas
- Barbados
- Belize
- Bermuda
- British Virgin Islands
- Cayman Islands
- Curacao
- Cyprus
- Gibraltar
- Guernsey
- Hong Kong
- Ireland
- Isle of Man
- Jersey
- Labuan
- Liechtenstein
- Luxembourg
- Madeira
- Malta
- Marshall Islands
- Mauritius

Article

“Published annually, the IFC Review provides the world’s leading international wealth management professionals with the most detailed, authoritative and comprehensive analysis on developments within the Tax, Trust, Banking and Investment sectors across the ....world’s leading international Financial Centres ”

Due Diligence: Fool or Fraudster?

By L. Burke Files, CDDP, President, Financial Examinations & Evaluations, Inc (01/01/2013)

When we are tasked with looking at the investment of business partners we tend to look for, quite reasonably, a fatal flaw - a reason to say no. This quick discussion is for sifting opportunities into one of two different fatal flaw categories as opportunities run by fool or fraudster.

An initial point to distinguish between fools and fraudsters is that fools ignore risks, fraudsters deny risks. Fools act in such a way almost as though they have blinders on and move blithely forward. Fraudsters ignore risks such as politics, zoning, conflicting rights or conflicting professional opinions. Further the fraudster, as they are premeditated, will swiftly condemn any party that challenges them dismissing the dissenters as ignorant or possessing some yet to be disclosed sinister motive.

As part of the sifting process our due diligence brain should engaged the promoter in many conversations. The idea is to note representations made by the promoter and check the consistency of those representations between the different meetings. Fools are likely to be more consistent than fraudsters they are true believers on their scheme as fraudsters will “tailor” each presentation to better match the mood of the audience.

One family of questions I like are the “projections” questions. Every set of financial projections I have every read over the last 30 years have had the same description attached to them. The promoters have always told me that “The financial projections are conservative.’ This description begs the assumption that the promoters possess other numbers, possibly more accurate numbers but have chosen only to provide these ‘conservative’ numbers.

Thus, my immediate retort to this representation, before I have even glanced at the numbers is:

“As you have told me your projections are conservative, you have led me to believe that you have a set of projections that are more accurate. A conservative projection assumes that you have other numbers, but you have proffered lower numbers so that when you start and you hit what you consider to be the real numbers - you’ll look like you worked extra hard. Can I see these other projections?”

Smart answer from the promoter,

“No, these are the real projections, it’s just everyone always calls their projections conservative. (This is a good honest answer).”

A fool will reluctantly agree and give some idea of the range of the other numbers and a story on why he chose the number presented. The fraudster, will have to pause and think on how to answer as they will not be certain if this is a buy in of the scheme or a challenge to the scheme or a challenge to them. The fraudster who sees this as a personal challenge will typically stutter or stammer and respond with a question of your questions to buy time to think.

I always follow all answers with:

“OK, your projections are conservative, what might happen to the scheme if your numbers wrong by half, or even better your growth is 200 per cent to 300 per cent higher.”

Netherlands  
Nevis  
New Zealand  
Panama  
Samoa  
Seychelles  
Singapore  
St Vincent & The Grenadines  
Switzerland  
United Arab Emirates

The honest answer - If we're off by half we missed something in our assumptions and the promoter will have to revisit those assumptions. If we are at 200 per cent to 300 per cent of our assumptions we are also likely in trouble as we are not operationally geared to double or triple the size of the scheme.

The fool's answer is great if we hit 200 per cent to 300 per cent - well then we will have a big party. The fraudster will argue with you and try to make you look wrong or belittle your lack of understanding on how the assumptions were derived as any challenge to the construct of the scheme is seen as a personal attack.

In life if the fates wish to punish a business the fates will cause the business to grow too big too fast. A real manager will know this, a fool ignores this and fraudster denies that such an event would be beyond their capability to manage.

For me and my due diligence brain, it is reassuring to see a wall or a computer completely plastered with spread sheets with multiple assumptions. These exercises in "what ifs" show to me the promoter has seriously been thinking about the scheme and how it can work and how it can fail.

We love to be enchanted and the heart of enchantment is a wee bit of deception. Fool or fraudster the objective is the same, it is to deceive. Thus, if the deception is a joy - it was an enchantment. However, if the deception is a disappointment - it has become a fraud.

Fools and fraudsters achieve the same results. They suck up large sums of money and deliver losses and excuses. The key difference between fools and fraudsters that I have found; fools arrive at the wrong destination first as fools are unimpeded by burdens of serious thought or planning as well as equally unburdened by any thoughts of premeditation.

**You need to be logged in to view this article**

You are currently not logged in; to log in please enter your username and password in the login section of this page. If you are already logged in and see this message, please go to Account Settings and purchase a new subscription. Articles which are displayed free for a limited time still require login for print functionality to work

**Subscribe now or try our free online trial for three months**

To get access to this article, and receive a subscription to our yearly article go to our [secure signup page](#).

To receive a **three month free subscription** to the online site, [sign up here](#).