



Above: Photographed by Hiroko Masuike/Getty Images

Unraveling MADOFF *By Marjorie A. Horwin, CPA and Miguel G. Farra, CPA, JD*

THE COLLAPSE of Bernard L. Madoff's investment company, Bernard L. Madoff Investment Securities, LLP (BMIS) has had some of its biggest impact in South Florida, where individuals, private foundations, public charities, pension funds and other entities reportedly suffered combined losses of several billion dollars.

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& Farra's (MBAF) Boca Raton office serving Palm Beach County and is responsible for the firm's Private Wealth Services Group.

MBAF is the first public accounting firm in Florida to set up a Special Task Force to deal with the recovery of funds related to the Madoff fraud case.

The scandal is having a major impact in South Florida because Bernard Madoff has a home in Palm Beach and long-standing ties in

The BMIS financial reports showed a series of exceptional annual returns that prompted clients to invest their own money or money of organizations in which they were officers or directors. In December, federal authorities alleged that those reports were fraudulent, and that the fund run by Madoff was not achieving the reported earnings.

Many Madoff clients in South Florida and around the world were unaware that Madoff

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confidence, and they are seeking new advice on restructuring their estate plans and investments and on improving their monitoring of investment managers," said Marjorie A. Horwin, CPA, who is the partner in charge of Morrison, Brown, Argiz

the region's civic and charitable communities. According to published reports, at least several dozen Madoff clients were South Floridians he knew as neighbors and through charitable and social events including many at the Palm Beach Country Club.

was committing fraud until December 11, 2008, when the Federal Bureau of Investigation arrested him in New York City on charges of securities fraud at BMIS.

The U.S. Department of Justice's criminal suit and the Securities and Exchange

Investors trusted Madoff because of a stellar reputation he had built over several decades and because of their personal contacts with him or references from friends and associates who knew him.

Commission, in a civil suit, estimated that BMIS and related Madoff entities lost approximately \$50 billion—which would make it the largest Ponzi scheme in history. Those losses included approximately \$17 billion that Madoff is reported to have had under management as of early December.

Since mid-December, Madoff clients in South Florida, New York and around the world have been seeking advice from CPAs, attorneys and other advisors to determine how much money they lost and to begin working with the Internal Revenue Service and the courts to obtain the return of at least some of that money.

Refunds may be as a result of tax dollars expended for reporting of phantom income or for principal losses in the current year that may affect prior and future filings.

“It is urgent that Madoff clients begin the process of determining the amount of the loss in order to obtain tax refunds as early as possible,” said Miguel G. Farra, CPA, JD, and the head of the Tax Department at MBAF.

MBAF’s areas of focus include:

- Computing the amount of loss realized by the client.
- Assisting the client in gathering supporting documentation to substantiate the loss.
- Determining the ability to take an ordinary tax deduction as a theft loss for principal invested.
- Amending prior year tax returns that include fraudulently reported investment earnings (protective claims may be required in order to extend the statute of limitation for tax refunds) or including this phantom income as a current year theft loss.

- Potential carry back of net ordinary losses that were not utilized in the current year, including professional fees associated that have been incurred as a result of this theft loss.

- Potential carry forward of remaining net operating losses due to loss of principal that will be a tax benefit in future years.

- Working with counsel regarding SIPC filings that are typically due within 60 days of the notice of the published proceeding. SIPC has a reserve fund of fees paid by member brokerage firms. BMIS was a member of the SIPC. SIPC uses funds from its reserves to satisfy claims of up to \$500,000 for each investor in a failed member firm. Direct investors in BMIS may be eligible for payments from SIPC. It has not been determined whether investors through feeder funds will be offered the same protection.

- Working with counsel regarding clients that were invested in outside entities investment or managed by Madoff and his affiliates.

The MBAF Special Task Force is working to help determine if clients are eligible for IRS refunds in cases where reported earnings were the result of fraudulent or other incorrect tax reporting information supplied by Madoff.

“In addition to the potential loss of principal, the prospect of distributions to the Bankruptcy Court is one of the biggest concerns for Madoff clients,” said Horwin.

Madoff clients must realize that the Madoff firm’s records obtained by the bankruptcy trustee may be incomplete. That makes it vital for clients to have accurate records of their Madoff investments. Thus, investors must go as far back as possible into their records to show all of their deposits, withdrawals and other activities. For

individuals who put money into a feeder fund or other vehicle that invested in BMIS, having a complete record of transactions is important for their own purposes and that of the organization. Feeder funds are partnerships that invest all or portions of their assets into an investment fund.

Madoff clients may need to show when they made withdrawals and whether they were of principal or income or a combination. The trustee might also ask Madoff clients for information on why they made withdrawals from their investments and whether they withdrew consistent sums on a regular schedule.

Providing that information can help a client build a case of not having inside information about any possible fraud in Madoff’s investing.

“This is by no means a slam dunk to get these tax refunds,” said Horwin.

She noted that there are several recent court cases that have a similar fact pattern to the Madoff alleged Ponzi scheme. In these cases the taxpayer was precluded from receiving an income tax refund for a theft loss because it was determined that there was a reasonable prospect for recovery in the year of the reported loss.

There are related issues with declaring additional theft loss due to the reporting of phantom income. In one specific case a loss for phantom income was not permitted because there was no evidence that such income ever existed. A similar conclusion was made with taxes paid on phantom income because it was held that no theft of the taxes occurred.

It may take several months or longer to determine the full extent of outstanding assets remaining owned by Madoff and BMIS. This



Marjorie A. Horwin

could delay determination of whether there are any material assets that could be used to repay creditors.

Palm Beach, Broward and Miami-Dade residents who are active in the charitable and social community and who invested (either directly or indirectly through feeder funds) with Madoff are among those who have contacted MBAF.

Since December, Madoff clients and virtually everyone else who follows the news have been asking: "How did this happen?"

The basic answer is that investors trusted Madoff because of a stellar reputation he had built over several decades and because of their personal contacts with him or references from friends and associates who knew him. Madoff's resume includes a term as chairman of the NASDAQ Stock Market.

Some of the South Florida individuals and directors of some local organizations that placed money with Madoff knew him from social and civic gatherings.

Madoff, now 70, began working with Wall Street firms during the early 1960s. He formed his own investment firm in the 1970s, with his brother and later his two sons as senior officials.

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He began reporting profitable returns and continued to build his asset base with a strategy of owning stock and buying and selling options with the goal of reducing downside risk.

In most years since the 1990s, BMIS reported annual returns of at least 10 percent, even in years when overall stock market returns and those of many other investment firms with hedge fund strategies were considerably lower.

But even though Madoff's company was registered with the Securities and Exchange Commission, newspapers report that it did not always provide full required disclosures and details of its transactions in reports to investors. In addition, Madoff reportedly rebuffed some investors' requests for explanations of his investment strategy.

Amid the 2008 financial downturn, some investors who were concerned about that limited disclosure began withdrawing portions of their investments with Madoff.

Meanwhile, criminal authorities and financial regulators had begun investigations of Madoff, based in part on concerns expressed by some clients.

The FBI arrested and criminally charged Madoff on December 11, after he admitted to perpetrating criminal fraud on his clients. The following day, the SEC appointed a receiver for BMIS and froze its assets.

In a Ponzi scheme, which Madoff is accused of perpetrating, the fund manager or other perpetrator makes

interest payments and other payments to original investors by using money from follow-up investors. The manager reports those payments as legitimate returns on investment. The scheme can continue until the perpetrator has no new investors to fund payments to earlier investors.

The Madoff scandal has made headlines in South Florida partly because the list of largest investors includes the Picower Foundation of Palm Beach and several other prominent civic and government organizations.

The Picower Foundation lost a reported \$1 billion in the Madoff collapse, and



Miguel G. Farra



Morrison, Brown, Argiz & Farra (MBAF) LLP, announced the establishment of a Special Task Force to help clients and investors with recovery efforts in the Madoff fraud case.

was forced to close in late December. The Picower Foundation had been a major contributor to programs of organizations including the Kravis Center, the Palm Beach County School District and the South Florida Science Museum.

Public charities, private foundations and other institutions place assets with investment managers while they are seeking an appropriate civic or charitable contribution.

“It is very unfortunate that some of these organizations that lost money through Madoff might not be able to continue their former levels of support for charitable causes, education, health care and other important civic causes,” said Argiz, who in addition to being the Managing Partner of MBAF, is the 2008-2009 chairman of the Board of Trustees of the United Way of Miami-Dade.

As of early January, a complete list of Madoff investors was not publicly available.

According to published reports, the West Palm Beach Police Pension Fund lost \$838,000 due to investments with Madoff. That represented less than one percent of the fund’s \$161 million in assets.

Numerous other investors, including prominent foundations, financial com-

panies and individuals suffered larger losses—in total or as percentages of their total assets.

That list reportedly includes Fred Wilpon, owner of the New York Mets, actor Kevin Bacon and charitable trusts affiliated with Nobel Laureate Elie Wiesel, newspaper publisher Mortimer Zuckerman and film-maker Steven Spielberg.

Investment funds run by Grupo Santander, HSBC Holdings, Nomura Group and other major international banks reportedly placed multi-millions with BMIS and other Madoff entities.

Those large banks have hedge funds and other funds with money from wealthy investors who are seeking large returns, and are willing to accept relatively high levels of related risk. BMIS, which showed consistent annual returns above 10 percent, consistently attracted increased investment from those funds.

Many other investors placed money with Madoff based on friendships with him, or friendships with some of his long-standing investors.

The collapse of Madoff’s investment fund has led to calls for tighter regulation of money managers and other investment advisors.

It also is a chilling reminder for investors, whether they are individuals or directors of charitable organizations, family trusts or other funds, to heighten their own due diligence—before choosing

money managers and in monitoring their performances.

Investors that lost money through Madoff are now focused on recovery efforts. While working with CPAs, attorneys and investment advisors on those tax and bankruptcy court matters, the investors are also carefully evaluating and performing due diligence on their investments to reduce the risk of becoming involved with ‘the next Madoff.’”

Morrison, Brown, Argiz & Farra (MBAF) LLP, is the largest independent CPA firm in Florida and the 43rd largest in the country. On December 18, 2008, MBAF announced the establishment of a Special Task Force to help clients and investors with recovery efforts in the Madoff fraud case. The Special Task Force is comprised of tax specialists in the Tax Department, CPAs and other financial advisors in the Private Wealth Services Group as well as fraud examiners from the firm’s Forensic Accounting Division. It is working with attorneys, investment advisors and other representatives as well as individuals, families and charitable organizations to obtain tax refunds and other recoveries of their investments. MBAF has been recognized by INSIDE Public Accounting for 13 years as one of the nation’s 25 “Best of the Best” accounting firms. MBAF has clients in 48 states and in 31 countries. To subscribe to the Special Task Force Advisory, please log on to the RSS feeds at www.mbafcpa.com SA

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