

9. BANK AUDITOR FROM TEXAS (True Story)

A radio station in Texas invited me to speak about bank loans. After I spoke, a man called, identifying himself as a former CPA bank auditor. He told me he always knew that something was wrong, but could never quite put his finger on it. In a matter of minutes, I explained how I felt. The bank auditor was concerned that he could go to jail. I suggested we do some role playing, as if we were in court. I told him to pretend he was on the witness stand. I said, "Do you have the competence to conduct the bank audit?"

He said yes. He admitted that under CPA ethics he had no choice but to say yes.

I asked, "Did you determine if the bank legally owned the promissory note?"

He said, yes, that this is part of the audit requirement.

I asked him, "On a \$100,000 bank loan, how much legal tender must the bank loan in order for the bank to legally own the \$100,000 promissory note?"

He responded that it would have to loan \$100,000. I knew he had just made a fatal mistake.

I asked, "What does a \$100,000 bank liability mean?"

He said it means the bank owes \$100,000 of legal tender.

I asked him if a check is money or merely an order to pay money?

He gave the standard reply, stating a check is the same as money because you can redeem it in cash.

I asked him if, according to the Uniform Commercial Code, it is money or merely an order to pay money?

He said, "Don't worry about it."

I said, "Do you have the competence to answer the question?" I knew he could not say no if he took on a CPA bank audit assignment. He finally confessed that it is not money, it is merely an order to pay money.

I asked, "According to the standard bank bookkeeping entries and according to the Federal Reserve Bank policy and procedures, who provided the original capital to fund the bank loan check? Was it the bank or the borrower?"

He said, "If I answered that question, I might go to jail."

He admitted the check and liability is not money. He admitted the bank must loan \$100,000 of legal tender to the borrower in order for the bank to legally own the promissory note. That means the promissory note cannot fund the bank loan check. He became very upset and concerned. He explained that, if the bank does not legally own the promissory note, then the audit was incorrect and must be changed. If this were done, it would open the door for a lawsuit. He very well might go to jail. The next day he called me, claiming he'd found a weakness in my argument and charging that the banking procedure was not check kiting.

I asked him if the word loan meant money advanced to a borrower to be repaid at a later date, usually with interest.

He said yes. He had no choice, he had to say yes. This definition comes from the dictionary.

I asked him if the bank records legal tender as a bank asset.

He said yes. This refuted his claim that the local banks have a license to create the opposite of legal tender (bank liability called checkbook money owing legal tender) and loan the opposite of legal tender to the borrower.

I asked him if it is standard policy for the banks to record promissory notes as a loan from the borrower to the bank. Obviously the answer is yes.

He knew I had the Federal Reserve Bank publications showing the standard bank bookkeeping entries, which recorded the promissory note as a bank asset offset by a new bank liability. This is economically the same as loaning the promissory note to the bank, and the bank loaning the value back to you. He knew that, if it is material to disclose a loan from the bank to you, it is equally material to disclose a loan from you to the bank. If it was not a loan, it had to be a theft. He could not answer the question.

I asked him, "According to your understanding, is the promissory note money or not?"

He told me he could not answer this question in court without going to jail. Later in the book, I will explain why he gave this response.

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About the author

Tom Schauf has a diverse background. He graduated from Northern Illinois University with a Bachelor of Science with double majors in accounting and finance.

After graduation, he worked as a staff accountant for Motorola. He worked for a small certified public accounting firm, owned and operated his own business brokerage firm and certified public accounting practice.

Over a period of nearly ten years, he has testified in a number of cases as an expert witness in business valuation, and has taught the arts of business acquisition and negotiations to buyers, CPAs, and lawyers on a national level in colleges and major universities.

He has taught lawyers and thousands of CPAs the art of valuation and negotiations in his copyrighted course designed to meet continuing education requirements.

He has been a controller, and head of purchasing and personnel for a major manufacturing company. He was also a real estate broker and aircraft flight instructor (CFII).

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