# Think Like A Thief

**by Jim Cali,**

**CPA, CFF, CGMA**

## TABLE OF CONTENTS



Copyright © 2013
James Cali, CPA; St. Louis, Missouri
forensicaccounting1984@yahoo.com

All Rights Reserved

**WHAT IS FORENSIC ACCOUNTING?**

**FORENSIC – Function: *adjective***

1. Relating to, used in, or appropriate for courts of law or for public discussion or argumentation.
2. Of, relating to, or used in debate or argument; rhetorical.
3. Relating to the use of science or technology in the investigation and establishment of facts or evidence in a court of law.

**ACCOUNTING – Function: *noun***

The bookkeeping methods involved in making a financial record of business transactions and in the preparation of statements concerning the assets, liabilities, and operating results of a business.

**FORENSIC + ACCOUNTING** = A specialty practice area of accountancy that requires knowledge of the courtroom, rules of evidence and investigative techniques.

**FORENSIC ACCOUNTING RULE # 1 - Never Underestimate The Value Of A Single Document.**

With all of the recent corporate accounting scandals at Parmalat, Xerox Corporation, and Satyam Computer Services, and all the high profile corporate frauds at Enron, World Com, and HealthSouth followed by Bernie Madoff's colossal ponzi scheme, the media has made Forensic Accounting into a growing industry.

While all of the recent media attention given to Forensic Accounting may give one the impression that this is something new, in reality the practice of Forensic Accounting has been around since the 16th century. Court records from Antwerp, Belgium show in 1554 Hercules DeCordes[1], a "Bookkeeper" was recognized as an expert witness when he testified about the accounting records he maintained.

In 1946, Maurice Peloubet[2], a New York CPA was the first person to coin the phrase "Forensic Accountant." For it is the Forensic Accountant that is tasked with the daunting responsibility of reconstructing the complex financial puzzle after the discovery of fraud, embezzlement, or elaborate ponzi scheme. It is the Forensic Accountant's mission to rebuild the entire financial system to uncover these sinister schemes. This is accomplished by painstakingly reviewing financial transactions such as; inventory records, payroll disbursements, cancelled checks, bank and credit card account records, wire transfers, cashier check purchases, expense reports, and non-financial information such as; emails, text messages, phone logs, purchase orders, vendor files, personnel records, and passport activity.

In most situations the Forensic Accountant will appear in court to present his work; therefore the Forensic Accountant must have knowledge pertaining to the rules of evidence for courtroom proceedings, and must demonstrate that due professional care and proper chain of custody was maintained for all paper and electronic evidence entrusted to him.

[1] Forensic and Investigative Accounting 5th Edition*:* D. Larry Crumbley*,* Lester E. Heitger, G. Stevenson Smith

[2] Journal of Accountancy*,* June 1946: Forensic Accounting: Its Place in Today's Economy by M.E. Peloubet

Upon completion of the forensic accounting engagement, the Forensic Accountant must be able to present his findings in a written report that is clear, concise, and convey the facts in a persuasive manner.

In short it is the Forensic Accountant's role to determine what happened, explain how it occurred, and offer a fair and reasonable evaluation for computation of damages. In some cases, the Forensic Accountant may be called upon to develop a series of recommendations to prevent and deter future losses.

**FORENSIC ACCOUNTING FOR CRIMINAL INVESTIGATIONS**

Today, Local, State and Federal Law Enforcement Agencies seek the use of Forensic Accountants to investigate financial crimes such as:

- Arson For Profit
- Bank Fraud
- Embezzlement
- Health Care Fraud
- Insurance Fraud
- Money Laundering
- Mortgage Fraud
- Organized Crime Business Enterprises
- Ponzi Schemes
- Securities & Commodities Fraud
- Tax Evasion
- Terrorist Financial Networks

The father of Forensic Accounting for law enforcement was none other that Mr. Frank Wilson.


Frank Wilson was a certified public accountant working for the Internal Revenue Service when, in 1930, he was assigned to a Federal task force investigating the notorious Chicago gangster, Al Capone.

In searching records, Wilson found an accountant's cash receipts ledger showing net profits from gambling with the organized crime boss Al Capone's name on it.

It was this single document that allowed Wilson to prove that Al Capone had indeed earned "illegal income" which he had failed to report, that was subject to Federal Income Taxation.

Although there had been many attempts to convict Capone for various other illegal activities, he was never found guilty. In fact he thought Wilson's investigation and the tax evasion charges were a joke.

In response to these charges he stated the following: "The income tax law is a lot of bunk. The government cannot collect legal taxes from illegal money."

In 1931 on the strength of the Forensic Accounting analysis of Capone's personal and business accounting records by Wilson, Al Capone was indicted for Federal Income tax evasion for the years 1925 through 1929, in addition to the failure to file tax returns for the years 1928 and 1929.

Wilson's detailed Forensic Accounting methods determined that Capone owed $215,080.48 in federal income taxes from his "illegal gambling profits."

Capone was found guilty of tax evasion and Judge Wilkerson sentenced him to ten (10) years in Federal Prison and one (1) year in the county jail.

Wilson's work on the Capone investigation set the foundation for modern day Forensic Accounting and Financial Investigation applications in law enforcement.

It was Frank Wilson, CPA who was able to prove to the world that it takes a Forensic Accountant to catch a crook!

**FORENSIC ACCOUNTING TOOLS**

In order to analyze the subject's financial transactions, the Forensic Accountant may have to search enormous amounts of data. When facing these circumstances the Forensic Accountant should begin his/her search with public record databases. Government entities in cities, counties, and states compile a wealth of information on both individuals and corporations.

On State websites the Forensic Accountant will find a vast array of information on every corporation registered with the state including; the names of the officers and registered agents for corporations, limited liability companies, limited partnerships, and general partnerships in addition to fictitious name registrations and lien filings are readily available online.

The City and/or County Property Appraiser has important information pertaining to the ownership and transaction history for every parcel of real and taxable personal property in the County. Additional real estate information is also available from a service called *Zillow*, which provides free real estate information about homes for sale, home prices, home values, and recently sold homes for any location in the United States at [www.**zillow**.com](http://www.zillow.com) .

All records pertaining to every legal proceeding are presented in court dockets which are maintained by the office commonly referred to as the Clerk of the Court. The Clerk of the Court's website can provide the details and copies of actual documents related to the court proceedings for the following: arrest and conviction records, traffic citations, affidavits and motions filed by plaintiffs and/or defendants, marriage licenses, divorce decrees, final rulings, disposition of property, in addition to a host of other court related documents related to the assessment and payment of fines, fees, and court costs.

Every city and/or county has an official Records Custodian. The information contained on the Records Custodian's website will provide the Forensic Accountant with the details for every "recorded document" such as deeds, declarations of domicile, foreign judgments, domestic partnership registration, liens , evictions, foreclosures, writs of replevin, writs of elegit, and writs of fieri facias.

Forensic Accountants that are also members of the law enforcement community have access to a number of specialized investigative websites and databases.

The first of these systems is maintained by the Federal Bureau of Investigation (FBI) and it contains a comprehensive database of criminal justice information in a computerized system known as the National Crime Information Center more commonly referred to as NCIC. The information in NCIC may assist the Forensic Accountant in locating and returning stolen property. More information about NCIC maybe be found at the following link; http://www.fas.org/irp/agency/doj/fbi/is/ncic.htm .

The second system, known as the Financial Crimes Enforcement Network, or FinCEN, was developed by the United States Department of the Treasury. FinCEN's mission is to enhance U.S. national security, deter and detect criminal activity, and safeguard financial systems from abuse by promoting transparency in the U.S. and international financial systems. FinCEN can provide Forensic Accountants with a variety of financial information pertaining to an individual and/or a corporation such as the location of bank and stock broker accounts, details of wire transfers, cash transactions, and suspicious activity involving financial institutions, casinos, insurance brokers, security dealers, check cashing stores, foreign currency dealers, jewelers, and precious metal brokers. More information about FinCEN maybe be found at the following link; http://www.fincen.gov/ .

It is important to note that any information the Forensic Accountant obtains from FinCEN is considered to be protected information as defined by the "safe harbor" provisions of the Bank Secrecy Act. As protected information, any documents provided by financial institutions to FinCEN are not subject to discovery and cannot be disclosed to a third party or used as exhibits during trial. This advisory is provided to inform financial institutions of the recent court decision concerning the "safe harbor" provision of the Bank Secrecy Act as applied to reports of suspicious transactions.

It is extremely important for the Forensic Accountant to organize and catalog all material received during the course of the financial investigation.[3] In an effort to facilitate the collection and classification

[3] The Forensic Accountant and Fraud Examiner's Tool Kit 2nd Edition: James Cali, CPA, CFF, CGMA

of data, a Background Investigation Checklist is provided in Exhibit 1 and a Financial Investigation Checklist is provided in Exhibit 2.

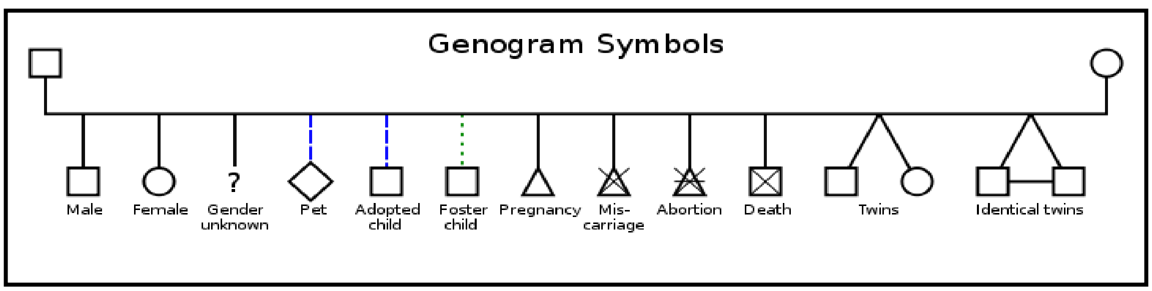
**SURVEILLANCE AND INVESTIGATION TOOLS**

Pen registers and mail covers are two surveillance and investigation tools commonly used by law enforcement agencies that are extremely useful to the Forensic Accountant.

A Pen Register is an electronic device that records all numbers dialed from and to a particular telephone line. The term has come to include any device or program that performs similar functions to an original pen register, including programs monitoring internet communications. Information obtained from a Pen Register can provide the Forensic Accountant with knowledge of foreign bank accounts and key data that can be used to produce a genogram.

A genogram is a pictorial display using symbols. (see Figure – 1) and lines to illustrate a person's relationships with other individuals. These graphic displays can be used by the Forensic Accountant at trial to help the judge and jury understand the intricate workings of a complex money laundering or fraud scheme.

## Figure - 1




"A mail cover is a law enforcement investigative technique that captures any data appearing on the outside cover of sealed or unsealed class of mail, or by which a record is made of the contents of any unsealed mail. Mail covers are allowed by law to:

1. obtain information to protect national security;
2. locate a fugitive;
3. obtain evidence of the commission or attempted commission of a crime;
4. obtain evidence of a violation or attempted violation of a postal statute; or
5. assist in the identification of property, proceeds, or assets forfeitable under law." [4]

A mail cover does not involve the reading of the mail but only information on the outside of the envelope or package that could be read by anyone seeing the item anyway. Mail Covers can provide the Forensic Accountant with vital information pertaining to income from unknown sources as well as an individual's lifestyle and spending habits. An example of a Mail Cover is presented in Exhibit 3.

---

[4] Title 39, Code of Federal Regulations, Chaper 1, Subchapter D, Part 233.233.3 and Section 213 of the USPS Administrative Support Manual

**FRAUD**

What truly is fraud? It is so commonly used to describe all sorts of acts and misdeeds, but is there a universal definition of fraud?

In my humble opinion, the best definition of fraud comes from the Black's Law Dictionary. For only the mind of a skilled "Barrister-at-Law" could craft such a comprehensive definition of fraud:

> All multifarious means which human ingenuity can devise, and which are resorted to by one individual to get an advantage over another by false suggestions or suppression of the truth, and includes all surprise, trick, cunning or dissembling, and any unfair way by which another is cheated.

In reality all states have statutes that define was constitutes fraud. In order for an questionable act to be considered to be a fraud all four (4) of the following elements must be present:

1. A false representation or willful omission regarding a material fact
2. The fraudster knew the representation was false
3. The victim relied on this misrepresentation
4. The victim suffered damages or incurred a loss

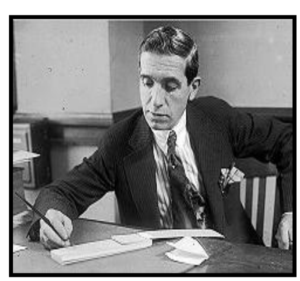
If any one of these elements is missing, then a fraud has not occurred. It may be an embezzlement, or grand theft, but in the eyes of the law it would not be fraud.

While the amount of fraud seems to be limited only by the imagination and ingenuity of the fraudster, the truth is that majority of most frauds can be traced to one (1) of only eleven (11) classic fraud schemes. For a fraud to be successful it has to look like something real. Many of these schemes are perpetrated with the willingness and knowledge of senior management. The classic examples for "Cooking The Books" are as follows:

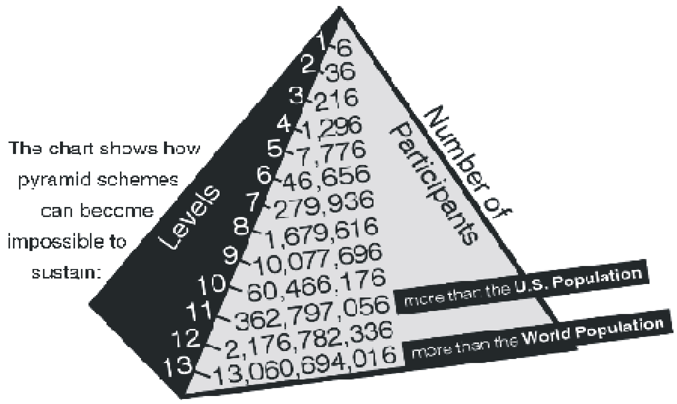
1. Fictitious and/or overstated revenues and assets.
2. Fictitious reductions of expenses and liabilities.
3. Premature revenue recognition.
4. Misclassified revenues and assets.
5. Overvalued assets or undervalued expenses
6. Omitted liabilities.
7. Omitted or improper disclosures.
8. Equity fraud.
9. Related-party transactions.
10. Alter ego.
11. Minimizing income or inflating expenses to reduce tax liabilities.

A detailed description of each of the eleven (11) classic fraud schemes along is presented in Exhibit 4.

The twelfth fraud scheme is named for Charles Ponzi, who is by far the greatest swindler in American history! The "Ponzi Scheme" is a scam that offers the promise of high returns on your investment. It pays "early investors" the "so called" return on their investment with the proceeds obtained from the "later investors."



**THE PONZI SCHEME**




Charles Ponzi’s scheme was so successful because he simply promised to pay all of his investors a colossal **400%** return on their investment, regardless of how much they actually invested!

By July 1920, Charles Ponzi had made millions. Ponzi was bringing in cash at a fantastic rate, but the simplest financial analysis would have shown that the operation was running at a large loss. As long as money kept flowing in, existing investors could be paid with the new money. In fact, new money was the only source Ponzi had to pay off those investors, as he made no effort to generate legitimate profits.

Records show that in the month of May 1920, Ponzi had received $420,000 from investors. To illustrate the sheer magnitude of Ponzi’s scheme, if the income for the month of May 1920, is adjusted for inflation, it would be worth approximately $4.59 Million in 2013 dollars.

Charles Ponzi began depositing the money in the Hanover Trust Bank of Boston , a small bank on Hanover Street in the mostly Italian North End of the city. Ponzi planned that once his account was large enough, he could impose his will on the bank or even be made the president of the Hanover Trust Bank of Boston.

Charles Ponzi never became the bank’s president; however, he did manage to purchase a controlling interest in the Hanover Trust Bank of Boston. Some eighty years later, a Ponzi biographer wrote, that the cash price Ponzi paid to purchase the controlling interest in the Hanover Trust Bank of Boston was suspiciously high, alluding to the fact that the shareholders of Hanover Trust Bank of Boston were directly involved in helping Ponzi continue his scheme. Research shows that people mortgaged their homes and routinely invested their life savings with Ponzi.

When Ponzi was no longer able to attract new investors, his scheme collapsed, leaving in its wake numerous investors with nothing.

Government investigators have tried for years to trace Ponzi's convoluted accounts in an attempt to determine exactly how much money his scheme had taken and how he had spent it; however, they never have managed to untangle his most unorthodox accounting records.

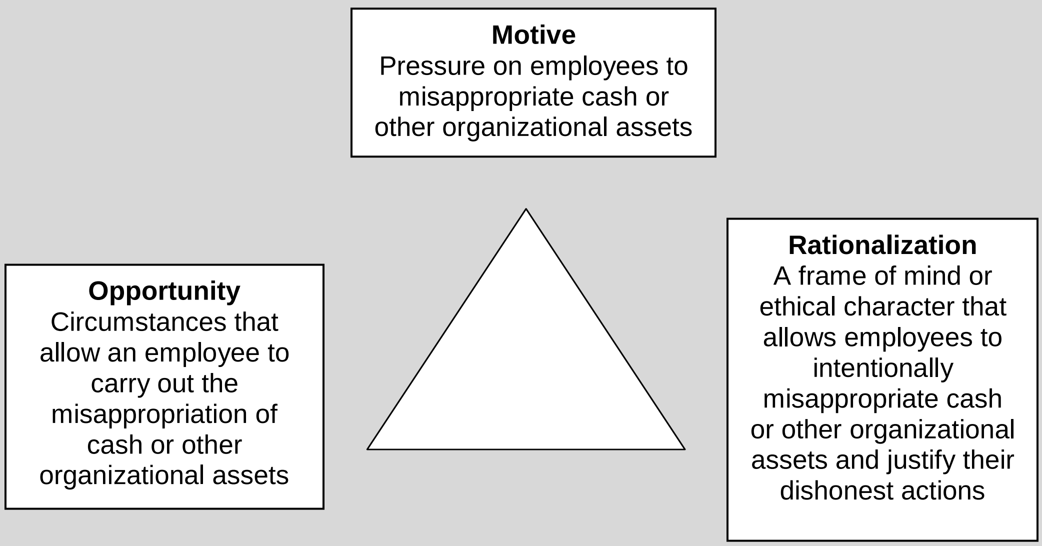
So beware, if the promised returns on the funds invested sound too good to be true …..
It is a “Ponzi Scheme”**!**

**THE FRAUD TRIANGLE**

In the 1950s, when the famed criminologist Donald R. Cressey was trying to develop a means to explain the underlying fundamentals of why basically honest people would commit fraud, he came up with the concept of a Fraud Triangle.[5](see Figure -2) The central point of Cressey's theory is that should an individual find themselves in a situation where they have to face the following three (3) elements of opportunity, motivation, and rationalization to commit fraud, they probability will.

**Figure - 2**

**The Fraud Triangle** [5]




**EMBEZZLEMENT**

Embezzlement is defined as*; The fraudulent conversion of another's property by a person who is in a position of trust, such as an agent or employee.*

Embezzlement is very different from fraud. A fraudulent act involves wrongfully obtaining property by a false pretense, such as a lie or trick, at the time the property is transferred. The key factor in an embezzlement, is that the embezzler is stealing from their employer and/or the agency that has entrusted the assets to them.

[5] Occupational Fraud Abuse, by Joseph T. Wells, CPA, CFE (Obsidian Publishing Co., 1997)

## THE STAR OF EMBEZZLEMENT

In my position as a CPA in law enforcement, I have had the good fortune to testify as a forensic accountant expert witness in numerous fraud and financial crime cases. To assist members of the jury in understanding my testimony on embezzlement cases, I found it beneficial to expand the concept Cressey used to develop his theory of the Fraud Triangle into what I refer to as Cali's *Star Of Embezzlement*. (see Figure – 3)

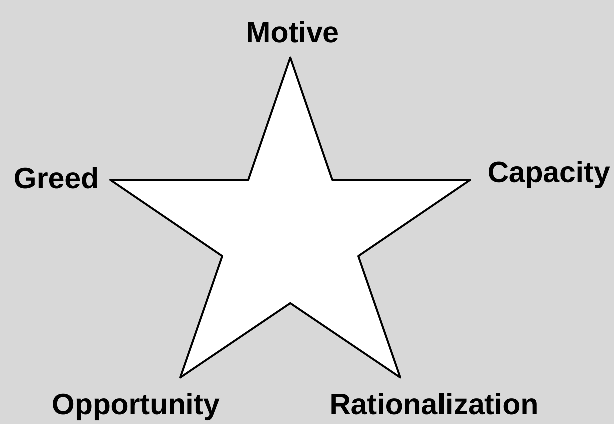
The *Star Of Embezzlement* adds two (2) additional elements, **Greed** and **Capacity** to Fraud Triangle.

In developing the *Star Of Embezzlement,* I simply used Webster's definition of **Greed** - *a selfish and excessive desire for more of something (as money) than is needed.*

However for the element of **Capacity** [6] I developed this view and it can be easily understood when the embezzler:

- Is in a position or function within the organization that gives them the ability to create or exploit a unique opportunity that is not readily available to others;
- Understands the internal control weaknesses, and their position or function allows them to take advantage of these weaknesses without being questioned;
- Has great confidence that their scheme will not be detected and believes that if questioned, can easily talk them self out of any trouble;
- Can use their authority to convince or coerce other to commit, conceal or simply ignore the fraudulent activity;
- Lies effectively and consistently to avoid detection;
- Possesses an ability to keep track of the lies to maintain a consistent and believable story; and
- Is able to successfully deal with stress (for committing, managing, and concealing an embezzlement scheme over a long period of time can be extremely stressful).

**Figure - 3** **The Star of Embezzlement**




[6] Bribery And Corruption Casebook, edited by Dr. Joseph T. Wells, CPA, CFE, Laura Hymes, CFE (Wiley, 2012)

**THE CRIMINAL MIND**

In an effort to understand the motive and rationalization for why an individual, with no criminal history, would one day decide to perpetrate sophisticated fraud schemes, or create fictitious vendors to embezzle company funds for their personal enrichment, one must delve into the inner workings of the perpetrator's mind.

In 1997 while doing research at Louisiana State University on the topic of "Occupational Fraud" which is defined as the abuse and misconduct of employees, managers, and principals against their organization, Lisa Eversole had the opportunity to analyze numerous frauds and the individuals that have perpetrated them. The characteristics presented in the table below are intended to help you recognize individuals with a potential for fraud and a means to explain their motive and the ability to rationalize their actions as being just and righteous.

- Male
- Intelligent
- Egotistical
- Inquisitive
- Risk taker
- Rule breaker
- Hard worker
- Under stress
- Greedy
- Financial need
- Disgruntled or a complainer
- Big spender
- Overwhelming desire for personal gain
- Pressured to perform
- Close relationship with vendors/suppliers

Ms. Eversole has refined her research and into a comprehensive report entitled "Profile of a Fraudster" [7] and a detailed discussion of each characteristic along with examples is presented here to assist you with your investigations of fraudsters, embezzlers. By carefully applying these characteristics you may be able to identify the individual that is falsifying their travel reimbursement reports and chronically abuses their sick-time may just be the one that is masterminding the next multi-million dollar securities fraud.

**MALE**

The typical perpetrator is a college-educated white male. Men commit three-fourths of fraud and abuse cases. Median losses caused by men are nearly four times those caused by women. The median loss per incident of fraud caused by males is approximately $185,000; by females, approximately $48,000.

An example of a male perpetrator is Fife Symington. In 1997, Arizona governor, Fife Symington, was found guilty of fraud. Symington, a two-term governor, faced 21 counts of bank fraud, attempted extortion, and perjury. Symington's fraud started in the 1980's when he easily obtained loans and lines of credit gave rise to numerous projects that later failed along with the real estate market. Symington built about two dozen buildings and shopping centers in the 1980s and early 1990s.

[7] Forensic and Investigative Accounting 5th Edition*:* D. Larry Crumbley*,* Lester E. Heitger, G. Stevenson Smith

When he first ran for office in 1990, Symington promised voters to run Arizona like his "successful development business". During his second term, his "sorry" financial state became public knowledge. Less than a year into his second term, Symington was bankrupt. Symington resorted to fraud to cover up his failed business dealings and to maintain his reputation for success, which undoubtedly influenced his election to governor.

**INTELLIGENT**

Fraudsters may feel challenged by "secure" systems. The individual may be bored by the routineness of their job.

The case of Stanley Mark Rifkin exhibits this characteristic. Rifkin stole $10.2 million from California's Security National Bank in less than an hour. Rifkin was a computer programmer who was creating a back-up system for Security National's wire room- the bank's communication center from where between two to four billion dollars are transferred a day. Rifkin had to learn the system, and as he did, he began to consider robbing the bank. On October 25, 1978, he stole an employee access code from the wall of the wire room, walked to a nearby telephone, and transferred the $10.2 million to a New York bank and then to Switzerland.

**EGOTISTICAL**

The perpetrator may be scornful of obvious control flaws. The employee feels that beating the organization is a challenge and not a matter of economic gain alone. Also, the individual may feel tired of "dumb" managers.

**INQUISITIVE**

The employee is overly curious about the job or organization. The employee may be tempted by the discovery of something new, such as computer vulnerability.

**RISK TAKER**

The individual is willing to bend the rules and take chances. The employee fails to consider the consequences of being caught.

Toshihide Iguchi, a bond trader at Japan's Daiwa Bank, was charged in 1995 with doctoring records to hide over $1 billion in losses. Iguchi lost the money through unauthorized trades over 11 years at Daiwa's New York branch. Iguchi had single-handedly concealed losses from bank superiors. Iguchi was in charge of the backroom operations that monitor trade, meaning he was policing himself. In addition to losing over $1 billion through unauthorized trades, Iguchi made unauthorized sales of the bank's government securities to cover up his losses. Iguchi entered into the unauthorized trades in hopes of profiting on the trades without the bank's knowledge.

**RULE BREAKER**

The employee takes short cuts. He/She self-justifies infractions of laws, rules, etc. Employee may think "everybody else does it, why not me?".

Gurmeet Singh Dhinsa , the owner of New York City Gas Company, defrauded customers and the government. Dhinsa defrauded customers with pumps electronically rigged to overcharge. He evaded state taxes by shipping bulk gas from out of state, where it is taxed less. In addition, Dhinsa ordered several killings in an attempt to cover up his fraudulent activity. Dhinsa had no regard for the illegality of his actions.

**HARD WORKER**

The employee is the first to arrive in the morning and the last to leave at night. The employee takes few vacations or is reluctant to be away from the office.

**UNDER STRESS**

The employee is suffering from a personal crisis, such as a financial problem, bad marriage, etc.

Take the case of Jerry Watkins, an employee of Ackroyd Airlines for 17 years. During his employment, Jerry held positions in accounting, finance, and finally, in purchasing. Jerry and his wife both had college degrees and worked full-time. Jerry and his wife had dreams of sending their three children to college.

Despite their plans for college, the Watkins spent most of what they made and saved very little money for college tuition. Jerry’s oldest son started college at an Ivy League university. Jerry, who handled all of the family finances, found himself unable to pay his son’s college expenses, let alone education expenses for their other two children. Jerry, a "proud" man, could not bring himself to admit his "financial inadequacy" to his wife and children. Jerry could not borrow the money he needed because he already had a large mortgage and other debts.

Because of his financial predicament, Jerry started to embezzle funds from Ackroyd Airlines. In his position as purchasing manager, he found it easy to take kickbacks from a vendor who had approached him with favors to get business. Jerry experienced severe stress as a result of not being able to pay his son’s college tuition that resulted in fraudulent activity.

**GREEDY**

The employee is not satisfied with the resources available to him. He/She desires more than they have.

In 1981, Barry Minkow, an ambitious sixteen year old high school student, started a carpet cleaning business called ZZZZBest. ZZZZBest initially was a business failure. Minkow ignored the day-to-day operations and cost controls, required of a new organization. By the time he was 17, Minkow was heavily in debt. Despite his debt, Minkow decided to open another location of ZZZZBest. He was determined to have ZZZZBest bring him financial success.

As his expenses increased, Minkow could not meet his debts and turned to insurance fraud to raise money. He would stage a break-in at a ZZZZBest location and claim a loss. Also, Minkow reported fictitious equipment to secure loans, falsified work order contracts to secure loans, stole money orders for cash, and added zeros to customers bills who paid by credit card. Minkow was living the "good life" with a new sports car and condominium.

Minkow decided to make ZZZZBest a public corporation in 1986. Minkow falsified financial statements to greatly improve the financial position of ZZZZBest. In order to avoid the SEC's scrutiny of the financial statements, Minkow used a backdoor to take his company public called the shell route. He merged ZZZZBest with Morningstar Industries, an inactive Utah mineral exploration firm, and acquired Morningstar's publicly owned shares in exchange for stock in the newly formed corporation. Minkow personally received 76% of the shares. He was now worth $12 million on paper. Minkow was continually raising money from new investors to pay off old investors. By April of 1987, ZZZZBest stock was selling for $18 a share. The company's book value was $210 million. Barry Minkow was worth $109 million on paper. In 1987, 21 year-old Minkow met with the Wall Street firm of Drexel, Burnham, Lambert. Drexel agreed to raise $80 million, via junk bonds, for ZZZZBest to buy out KeyServ, a cleaning service.

As a result of numerous television appearances, Minkow became something of a media celebrity. He was featured in *Newsweek* and *American Banker*. He developed a reputation as a legend of an entrepreneurial prodigy. However, this reputation would change after an investigative report published in the *Los Angeles Times* on May 22, 1987. The report identified Minkow as the "whiz kid" behind a trail of false credit card billings. Minkow, the boy wonder, was now the "kid who swindled Wall Street". Within a month ZZZZBest stock plummeted from $18 to $6.

In July 1987, Minkow resigned from ZZZZBest at the age of 22, citing ill health. ZZZZBest shares were selling for just pennies. Minkow was charged with bank, stock, and mail fraud, money laundering, racketeering, conspiracy, and tax evasion. ZZZZBest, a company once purported to be worth hundreds of millions of dollars, auctioned off its entire assets for only $62,000.

**FINANCIAL NEED**

The employee's need cannot be satisfied with available resources. Financial need can be the result of major financial losses, drug or alcohol dependencies, illness, gambling losses, greed, or overextended credit.

A bank teller had a $30,000 a day gambling habit on a $11,000 a year salary. In 1970, the chief teller at the Park Avenue branch of New York's Union Dime Savings Bank embezzled more than $1.5 million from hundreds of accounts. Despite having no formal computer training, he was able to shift nonexistent money around from account to account, falsifying quarterly interest payments and satisfying visiting auditors with ease.

The discovery of the fraud was uncovered by accident. A routine police raid on a bookie revealed that the bank teller had been betting as much as $30,000 a day on sporting events.

**DISGRUNTLED OR A COMPLAINER**

The employee feels abused by the employer and wants to get even. He/She feels frustrated or dissatisfied about some aspect of their job. The employee may try to get even or take what he/she "really deserves". The employee may feel pay is not commensurate with their job responsibility. In general, the employee is frustrated with the organization. Frustration can result from a number of situations, such as not being promoted, a perception of being underpaid, dislike for a supervisor, a feeling of alienation from other employees, a lack of devotion to the company, fear of losing one's job, or boredom with the work. The employee has low job morale.

**BIG SPENDER**

The employee is living beyond his/her means. If the demands of an employee's lifestyle exceed his/her pay, the employee is a candidate to perpetrate a fraud. The employee may make extravagant purchases or have a lavish lifestyle.

**OVERWHELMING DESIRE FOR PERSONAL GAIN**

The employee may desire personal gains from their job such as promotions, bonuses, or recognition.

John Spano, the Texas businessman charged with defrauding lenders in a bid to buy the New York Islanders hockey team, wanted the personal recognition that comes with owning a professional sports team. The Dallas businessman pledged $165 million to buy the New York Islanders. The National Hockey League approved his offer. Spano overestimated his financial worth. He convinced others that he was worth $100 million when federal prosecutors say he may have been worth less than $100,000. Spano never had the money even though an executive at CoAmerica Bank in Dallas apparently vouched for his money and Fleet Bank lent him $80 million toward the Islanders' purchase. Spano forged bank letters and altered documents he sent to the banks. In the end, Spano failed to deliver the checks as promised to the New York Islanders. Spano was arrested on charges of bank and wire fraud. He was accused of making fraudulent claims to obtain a bank loan, making false statements to support his loan application, committing fraudulent acts to obtain the team's cable-television rights, and spending thousands of dollars of the team's money after fraudulently assuming ownership. Spano's love for hockey and desire to own the NHL team led him to his fraudulent activity.

**PRESSURED TO PERFORM**

The employee may be pressured to meet unrealistic financial expectations.

Cincinnati Reds owner, Marge Schott, was guilty of defrauding General Motors. The names of Cincinnati Reds executives and relatives were among those that General Motors said Schott used to falsify 57 auto sales at her car dealership. The people whose names were involved in the fraud were unaware of the situation and were not involved. GM told Schott in 1995 that her Chevrolet dealership was not meeting company sales standards. In June 1995, Schott reached a settlement with GM that she would surrender the dealership if it did not meet its quotas in two of the final three quarters of 1995 or the first two quarters of 1996. Under pressure to meet the sales quotas, Schott falsified sales to meet quotas.

**CLOSE RELATIONSHIP WITH VENDORS/SUPPLIERS**

The employee may develop a close or personal relationship that extends beyond proper business relations.

Rick Hendrick, one of the nation's largest auto dealers in the mid-1990s, was charged with conspiring to bribe Honda executives to get extra cars and dealerships. Hendrick owned Hendrick Management Corporation, which controlled 66 automobile and truck dealerships. Hendrick bribed executives of Honda and, in return, received preferential treatment for getting Honda automobiles as well as receiving Honda dealerships. A top Honda manager testified during a trial in March 1995 that Hendrick helped him purchase two homes. Hendrick acknowledged giving gifts to the manager but claimed they were given as a friend, not to buy influence.

The fraudster can be a CEO, a mail room clerk, or anyone in between—all it takes is opportunity, need, and rationalization. Lower level white-collar employees commit most frauds, but the largest most damaging frauds are committed by senior executives and owners of businesses. Losses caused by managers who committed fraud are four times greater than those committed by lower level employees. Median losses from fraud caused by executives were 16 times greater than those of lower level employees.

**CONCLUSION**

Given the right pressures, opportunities, and rationalizations, every individual is capable of committing the financial crimes of fraud and/or embezzlement.

Once a fraud and/or embezzlement is detected:

- Call Legal Counsel.
- Call Law Enforcement.
- Secure the Crime Scene.
- Take immediate action to safeguard existing assets from further damage.
- Notify only the Managers that need to know.
- Notify the Insurance Carrier.
- Call in Professionals to assist in the crisis.
- Take action to identify and eliminate any conflict of interest issues.

**ABOUT THE AUTHOR**

Jim Cali currently serves as the Director of Internal Audit for the Bi-State Development Agency in St. Louis, Missouri. He is a Certified Public Accountant (CPA) with 30+ years of auditing and accounting experience, including internal audits, financial audits, and forensic accounting, and financial investigations. He has been professionally recognized by the American Institute of Certified Public Accountants with a Certification in Financial Forensics (CFF) and the certification as a Chartered Global Management Accountant (CGMA). He has conducted financial investigations for over 100 criminal cases involving organized crime, terrorist financing, cargo theft, drug trafficking, embezzlement, bank fraud, securities fraud, insurance fraud, mortgage/loan fraud, auto theft, prescription drug diversion, arson-for-profit and money laundering.

He has worked as the Forensic Accountant on joint investigations with local, state, and federal law enforcement agencies in addition to law enforcement agencies from Canada, Barbados, Bahamas, Haiti, Jamaica, and France. He has testified as a Forensic Accountant in state and federal courts, before Grand Juries, and as an expert witness in both criminal and civil proceedings.

On September 7, 2007 Jim received the "Outstanding Law Enforcement Officer Of The Year Award" from the United States Department of Justice for his financial investigation related to a nation-wide prescription drug diversion and money laundering case.

In 2008 he developed a graduate level Forensic Accounting course that is being taught at the University of Missouri – Columbia and Southern Illinois University – Carbondale.

Professionally, he serves as on the Board of Directors for the National Forensic Science and Technology Center (NFSTC) and the Missouri Society of Certified Public Accountants (MSCPA). Mr. Cali is also member of the Association of Certified Fraud Examiners (ACFE), American Institute of Certified Public Accountants (AICPA), Institute of Internal Auditors (IIA), and International Association of Arson Investigators (IAAI).

Copyright © 2013
James Cali, CPA; St. Louis, Missouri
forensicaccounting1984@yahoo.com

All Rights Reserved

## Exhibit 1
## Background Investigation Checklist

Full Name

Prior Name

Aliases

Social Security Number (SSN)

Date of Birth (DOB)

Vehicle Information

Driver License History

Litigation History

Criminal History / Arrest Record

Sex Offender Status

Bankruptcy Filings

Tax Liens /Judgments / Garnishments / UCC Filings / Liens

Internet Search (Emails, Text Messages, Google, Face Book, Twitter)

Associations / Persona l/ Business

Marital Status / Martial History / Divorce Decree

Former / Current
- Employer
- Co-Workers
- Neighbors
- Spouses
- Landlords

Education Verification

Immigration Status

Employment History

Professional Licenses (Current Status/Disciplinary Actions)

Firearm Registrations

## Exhibit 2
## Financial Investigation Checklist

Real Estate Ownership

Vehicle Registrations

Boat / Aircraft Ownership

Business / Corporation Ownership

Stock / Bond Investments

Retirement Funds (IRA, 401K, 403B, 457)

Domestic Bank Accounts

Foreign Bank Accounts

Insurance Policy Ownership

Litigation / Insurance Settlements

Inheritance

Gambling / Lottery / PowerBall Winnings

UCC Filings / Liens

Employment History

Professional Licenses

Collections (Art, Antiques, Sports Memorabilia, ect.)

Government Benefits

Bankruptcy Filings

Tax Liens

Judgments / Garnishments

Credit Reports

Safe Deposit Boxes (Cash, Jewelry)

Employer Identification Number (EIN)

Marital Status / Martial History / Divorce Decree

**Exhibit 3**
**First Class Mail Cover**

## Listing of First Class Mail Delivered to a Specified Address or Addressee

**Warning: The following information is provided by court order at the request of your agency. This form is the property of the US Postal Service. It is provided for law enforcement purposes only. This form and all attachments must be returned within 30 days in the original to the Postmaster whose name and address appear on the cover letter to this form. It is a violation of Federal Law to copy this form or to share it contents with any unauthorized person.**

**Party________________________** **Route #____________**

**Address______________________** **Carrier Initals_______**

**Address______________________** **Start Date__________**

**City & State___________________** **End Date___________**

| Delivery Date | Address of Delivery of First Class Mail | Delivery Date | Address of Delivery of First Class Mail |
|---|---|---|---|
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |

## Exhibit 4
## Classis Fraud Schemes

1. **Fictitious Or Overstated Revenues And Assets**[8]

   Fraudsters use any of multiple methods to create fictitious revenues or assets in order to inflate income on financial statements. A slightly different approach is simply to overstate income either by omitting elements that would lower actual revenues (such as returns of purchases) or by using mark-to-market accounting to make records of future income more "flexible."

   A common example of this scheme is the bill-and-hold transaction. To execute the bill-and-hold transaction, the customer agrees to purchase goods and the seller invoices the customer **but** retains physical possession of the products. The fraudster uses this scheme to count **both** sales and inventory on hand, resulting in the overstatement of revenue and inventory.

2. **Fictitious Reductions Of Expenses and Liabilities**[9]

   With this scheme, the fraudster motive is to improve the profit / bottom line shown on the financial statements by using a host of unscrupulous approaches with the creation of fictitious reductions of expenses and/or liabilities to mask the business's true losses and/or excessive debt.

   Common approaches for such fictitious reductions include the burial of deals likely to generate losses in the use of derivative instruments whose creation does not require an initial cash outflow so their creation does not need to be reflected in the books.

   The WorldCom fraud is a classic example of this scheme. WorldCom shifted almost $11 billion of expenses into their capital accounts called the actual expenses "an investment." This resulted in an increase in income of almost $11 billion.

3. **Premature Revenue Recognition**[10]

   Premature revenue recognition is a means of recording income as actual in order to inflate earnings, when in fact the sales have not been completed, the products delivered, or the invoices paid. In general, revenue from product sales should not be recognized in the books and on the financial statements until it has been realized or realizable and earned.

   Fraudsters use this scheme to recognize income prior to the actual delivery of the goods or services. Premature revenue recognition is the most common scheme used to "cook the books." This scheme is the number one reason that businesses must restate their financial statements.

[8] Forensic and Investigative Accounting 5th Edition: D. Larry Crumbley, Lester E. Heitger, G. Stevenson Smith
[9] ibid
[10] ibid

## 4. Misclassified Revenues and Assets[11]

Fraudsters use this scheme to intentionally manipulate financial statements by misclassifying securities or transferring securities to a different class that would trigger the recognition of gain or conversely postpone the recognition of a loss. For example the fraudster might misclassify a "debt security" as a "held to maturity security" to avoid having to recognize a decline in value. Conversely, transferring a "held to maturity security" to either "trading" or " available for sale" would allow the fraudster to recognize unwarranted gains.

Inventory is another favorite area for fraudsters to easily manipulate asset valuations. For example inflating inventory value achieves the same impact on earnings as manipulating the physical count. Fraudsters can simply create false journal entries that increase the balance in the inventory account, or they can delay the write-down of obsolete or slow moving inventory to avoid taking the required charge against earnings.

## 5. Overvalued Assets Or Undervalued Expenses And Liabilities[12]

Fraudsters commonly overvalue assets by simply setting prices that are unsupportable in accordance with the standard business valuation approaches. These assets might be bought to essentially pay of parties to which the fraudsters are beholden, sold to artificially boost income, or simply held and recorded on the financial statements at for more than their actual worth.

Accounts receivable offer the fraudster a myriad of opportunities for the manipulation of valuation. Generally Accepted Accounting Principles (GAAP) requires accounts receivable to be reported at "net realizable value." Net realizable value is defined as the gross value of the receivable minus an estimated allowance for uncollectible accounts. Fraudsters simply circumvent GAAP rules and underestimate the uncollectible portion of a receivable. Underestimating the value of the amount deemed to be "uncollectible" artificially inflates the accounts receivable's value and it is reflected at an amount greater that it net realizable value.

Conversely, failing or intentionally delaying to write off receivables that are know to be uncollectible, is another method fraudsters employ to overstate the value of assets.

## 6. Omitted Liabilities[13]

Omitted liabilities are the mirror image of fictitious revenues and assets. By using this scheme fraudster simply hide debt or employ other off-balance sheet financing, known as special purpose entities (SPEs), to avoid having to include the negative picture on the financial statements.

SPEs are commonly used to bury poorly performing assets because the SPEs transactions are not considered part of the business' financial statement. Enron used this scheme by creating a host of SPEs to hide billions of dollars of off-balance sheet debt.

---

[11] Forensic and Investigative Accounting 5th Edition: D. Larry Crumbley, Lester E. Heitger, G. Stevenson Smith
[12] ibid
[13] ibid

7. **Omitted or Improper Disclosures**[14]

Disclosure, one of the categories of management assertions in financial statements, requires that certain information, such as assets held as collateral and preferred stock dividends in arrears, be included in the notes to the financial statements. Fraudsters use this scheme to simply omit or issue improper disclosures to avoid having to show questionable transactions or bad news. For example, contingent liabilities may be intentionally underestimated and their likelihood of loss may be understated to minimize the negative effect they would have on the financial statements.

Improper disclosures can take the form of misrepresentations, intentional inaccuracies, or deliberate omissions in: descriptions of the business, its profitability, or its products, in media reports, interviews, financial statements, and annual reports.

Omissions may also occur in management discussions and other nonfinancial statement section of annual reports, SEC filings such as 10-Ks or 10-Qs, or in the general footnote section of the financial statements.

8. **Equity Fraud or Pump-N-Dump**[15]

Equity fraud also known as the Pump-N-Dump investment or securities fraud, involves the promotion and sale of penny stocks, nonexistent securities, or illegal securities investments as well as intentional misrepresentation or concealment of investment and financial related information.

Equity fraud causes third parties to suffer financial loss, allowing the fraudsters rake in huge profits. Equity fraud is usually perpetrated to deceive or mislead and it is illegal. The fraudsters use boiler rooms, shady stock promotions, real estate transactions, and corporate financial fraud to dupe investors.

9. **Related Party Transactions**[16]

Related party transactions involve the interaction between tow (2) parties, one (1) of whom can exercise control and/or significant influence over the operating policies of the other.

In this scheme the fraudster exploits a special relationship that exists between the parties, e.g., a corporation and a major shareholder, the parent company and its subsidiary, a purchasing agent and a specific vendor.

---

[14] Forensic and Investigative Accounting 5th Edition*: D.* Larry Crumbley, Lester E. Heitger, G. Stevenson Smith
[15] ibid
[16] ibid

## 10. Alter Ego[17]

Alter ego, or second self, is an equitable remedy which permits a person to win a dispute against a corporation that a plaintiff does not have standing to sue under regular law. Under this alter ego doctrine, the owners of a corporation are held responsible for corporate acts by "piercing the corporate veil" and disregarding the corporate entity.

The *Litigation Services Handbook* indicates that a two-prong test must be satisfied:

1. Such unity of interest and ownership exists that the corporation and shareholders no longer have separate personalities, and
2. Viewing the acts of the corporation alone will result in inequity.

Some of the key indicators fraudsters employ with the alter ego fraud scheme are: financial dependence behaviors, confusion about corporate identity, lack of separateness, questions relating to issues of dominance and control.

## 11. Minimizing Income Or Inflating Expenses To Reduce Tax Liabilities[18]

Simply put this is good old fashion tax evasion.

The fraudsters stretch available deductions or overstate expenses to reduce their overall tax liabilities.

All businesses seek to minimize and even avoid tax liabilities. The difference between avoidance and evasion is the key. Tax evasion is illegal. Tax evasion is defined as the willful attempt to circumvent the tax laws through misrepresentation or deceit. By minimizing income in these ways, fraudsters hide the true nature or misrepresent the facts to take advantage of a tax exemption or exclusion that simply does not actually apply. Some common tax evasion methods used by fraudsters as a follows:

- Making false or fraudulent claims for refunds.
- Deliberately omitting sales tax transactions on state sales tax filings for which the sales tax was actually collected from the customer.
- Failing to maintain records that show the true income and expenses of a business.
- Preparing documents and records that understate the true income or overstate expenses.
- Payment of cash wages to employees for the purpose of avoiding payment of withholding taxes and/or worker compensation insurance premiums.
- Opening and closing of a new business within the same year to evade taxes.
- Operating a business using someone else's name, social security number, or employer identification number, to avoid paying taxes.
- Avoiding the excise tax on gasoline and/or diesel fuel by stating the purchase is the "off road use" and then using the gasoline and/or diesel fuel for regular motor vehicles or boats.

---

[17] Litigation Services Handbook: M.J. Wagner and B.J. Goldsmith

[18] Forensic and Investigative Accounting 5th Edition*: D.* Larry Crumbley*,* Lester E. Heitger, G. Stevenson Smith