Embezzlements: Theft of the $1 million settlement

Look in your own backyard if there's money missing

By David Cook

Show me the money, and I will show you the embezzlement. Whether it's the bookkeeper running the books of a small law firm or the AP (accounts payable) manager of the Fortune 500 company, embezzlements peek around the corner.

This is the start of the story. Management complains to the police (or DA) who might decline without concrete evidence in hand. Absent the unusual, the harried DA and police lack the resources to tackle a complex embezzlement unless the victim produces credible, and *admissible*, evidence.

Show me the accounting books, and I will show you puzzled faces. The local DA: "We are prosecutors and not accountants but will prosecute if you bring me sufficient evidence to launch the search warrants." Absent a waiver of "Speedy trial rights," and continuance on the preliminary hearing by the defendant, the DA must be "locked and loaded" with admissible evidence upon the filing of the charges. The search warrants are the key to marshalling admissible evidence required for preliminary hearing. Drafting up the search warrant, capable of withstanding a later motion to suppress, is the battleground. Despite the tidal wave of "Law and Order," criminal cases plea out at 97 percent for federal and 95 percent for state courts.

Management turns to counsel who in turn hires a private investigator to provide a factual basis, and evidence, to justify the issuance of the search warrant. Search warrants do not drop from the sky but are borne of diligence by counsel and the private investigator.

Who is the suspect?

The suspect is a person who handles the accounts payable (checks going out the door), accounts receivable (checks coming in the door), payment of credit card or other routine expenses, control over electronic transfers of money (money managers), purchasing but with complete autonomy, sales of surplus or excessive products, unfettered access to company accounts, or has a company credit card. This is also the person with unrestricted access to cash flow, trust accounts, inventory (sales personnel who take back product or handle product deliveries) or other hard assets all which evidence the "means or opportunity," of a theft. Don't be fooled by the grandmother in the accounting department who delights management with homemade candy. Along with cooking confectionary products, she could be cooking the books on the side.

What do all these people have in common? Knowledge of the organization, the means to facilitate the checks, access to company cash and accounts, lack of direct or immediate supervision, and a motive? [Try greed, envy, hatred, or an insatiable need for cash to finance drugs, gambling or lifestyle abuse.]

What are the key attributes of the person? Excessive secrecy, sole control over accounting, bookkeeping, financial transactions and inventory, refusal to collaborate or cooperate with others, refusal or slowness to report, unexplained absenteeism, multiple accounting errors without explanation; incomplete financial reporting; bad record keeping or no records; inexplicable transactions, transactions that are abnormal, irrational and repetitive; missing or damaged computer files; no back-up, and inexplicable loss of paper files. Frequently these individual are highly antagonistic, belligerent, or combative as a means of intimidation to ward off tough questions or an investigation. The slightest hint of willful destruction of accounting or financial records sets off a deafening alarm gong. Sole control over purchasing, check approval and posting checks is common in theft cases. Sole control over AR (accounts receivable) collections and cash management. Sole control over purchasing and returns. Occasional refusals to take vacations or time off. Sole control over bank reconciliations. Common thefts include customers who order but return products, but the returns never hit the loading dock. The most popular: the sales person pads the customer's order with unwanted products which get diverted to the sales person, or confederate, but in which the customer pays by the statement and not invoice. This list can go on forever. The fact that the person accessed information outside their routine or department without good reason is another indication of potential misconduct.

What you have to know about the embezzler

You should know the salary of the person, the net and gross; the amount of disposable income, after payment of housing (mortgage or rent), support of family; the wages (and similar analysis of spouse); and the total of net disposable income. Number of children. What are the person's probable mortgage payments, average lifestyle expenses, car payment, 401k and IRA contribution, and other expenses? What is the model of the disposable income after considering all other expenses? The $75,000 gross salary translates into a

$55,000 net, and reduced by $50,000 of routine expenses for, maybe, $5,000 of disposable income, or about $416 a month. This salary, along with the salary of the spouse, frames, if not describes, a lifestyle. The $300,000 salary offers a lifestyle visibly different from a $30,000 salary.

What is wrong with this person's lifestyle?

Observe if clothing, shoes, and jewelry are inconsistent or in excess of the person's disposable income; house payments (or paying cash for the house or massive improvement) in excess of the person's disposable income or probable life savings; an unduly excessive wardrobe or expensive wardrobe, accessories or cars; multiple and expensive large family trips abroad accruing an expense in excess of disposable income; trips to exotic or expensive locales; sudden acquisition with little or no explanation (other than death of relative – but no probate). The courts view an inexplicably lavish lifestyle of potential evidence of theft, or embezzlement. (*U.S. v. Jackson-Randolph* (6th Cir. 2002) 282 F.3d 369, 376. See also *U.S. v. Cole* (4th Cir. 2011) 631 F.3d 146, 155-156.)

What is wrong with the department?

You can spot co-workers who are secretive or uncooperative; co-workers associated by marriage or family; co-workers linked by ethnic, language or strong religious affiliation. Thefts persist for years (or decades) because enablers, conspirators or participants conceal the theft. Conversely when the thief burns the enabler, rumors abound. While management might be ignorant that company funds are "walking out the back door," co-workers witness the theft. Daily.

What are common embezzlements?

Sometimes these embezzlements persist for many reasons: misuse of company credit cards; invoices from confederates for non-existent goods or service, or padded invoices; payment to non-existent vendors (who is the person anyway?), order of product, payment and return of product, but intercepting the refund check and forging the endorsement and deposit into dummy account; theft of accounts receivable checks, but writing off AR balances as paid or disputed and deposit purloined check with forged endorsements; payment of personal expenses tethered to payment of company expense to the same vendor (utilities, credit cards, leasing companies, post office, business services such as Federal Express); theft of postage or postal stamps; sale and invoicing of products to non-existent companies and writing off AR. Moreover the problem continues because of the sale of excessive, obsolete inventory or equipment without adequate records; an accounting department that does not account immediately for the receipt of checks, cash or other medium of payment leading to the stolen checks, as well as theft of undocumented product returns from the loading dock.

Most common: Checks bearing a forged maker signature to legitimate sounding payees, or bona fide payees who would refund the amount as an overpayment, but the refund check is captured and cycled into another account. This list is illustrative. [Nobody is immune. The former real estate manager of the *State Bar of California* (no less) embezzled $615,000 leading to her arrest, conviction and two-year, eight-month prison term. She directed the tenants to make out the rent checks to a name (other than the State Bar solely) that she controlled. [See, www.sfgate.com/ .../Ex-**State-Bar-manager**-sentenced-for-**embezzlement.]**

In working with law enforcement, counsel or the private investigator needs to identify and quantify the loss: how much money or property was taken, and that the loss is attributable to a theft and not bad bookkeeping or incomplete records. This is no easy feat. Also, whatever the initial estimate of the loss, it makes sense to triple the number. Embezzlers systematically destroy or scramble financial records for the purpose of hiding the theft, reducing the amount, or covering their tracks, but moreover obstructing, or delaying, the employer in discovering and quantifying the loss. The suspicion that records are mismanaged, lost, missing, inaccessible and rendering a routine business transaction – normally transparent, but now opaque – should set off the alarm bells. The person responsible for the record "mismanagement" is probably the suspect embezzler.

Spy catchers focus on lavish spending as potential evidence of illicit payments. Robert Hanssen (FBI), Aldrich Ames (Navy), John Walker (Navy) and James Hall (Army) engaged in lavish spending beyond their apparent income and assets which represented a financial "anomaly" and should have prompted an investigation. Hanssen even advised the investigators that an investigation would have readily revealed that he was spending money in excess of his government salary. (See *www.dhra.mil/perserec/adr/financesaffluence/affluenceframeset.htm.)*

By the way, if you are planning to sue the bank, please read Commercial Code section 3405(b) which immunizes a bank from liability if the person handling the check has near autonomous authority in handling incoming or outgoing checks. This authority includes the right to sign or endorse instruments on behalf of the employer, process instruments received by the employer for bookkeeping purposes, for deposit to an account, to prepare or process instruments for issue in the name of the employer, supply information determining the names or addresses of payees of instruments to be issued in the name of the employer, control the disposition of instruments to be issued in the name of the employer, or to act otherwise with respect to instruments in a responsible capacity.

Is this the end of the story? Well, no. Show me the risk, and I will show the solution. Buy a crime policy (fidelity or "3D" insurance) whose annual premium is about $3,000 for $1 million in coverage and lets the insurance company play Dick Tracy or sue the bank or maybe not.

While the victim of a scheme in which the employee forged endorsement might recover against the depositing bank, the insurance company who pays off the victim might not. (*Meyers vs. Bank of America* (1938) 11 Cal.2d 92 barred the insurance company from recovering against the bank who received for deposit checks bearing a forged endorsement.)


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