# A Fraud Case Study

By David H. Glusman, CPA, DABFA, CFS, CrFA

**What Happened:** The initial call came on a Friday before Memorial Day Weekend. The Chairman of the Board ("COB") just found out that a $500,000 check cleared his bank and the bank called to advise him that he needed to activate the Company's line of credit. The COB was quite perplexed; he understood that he had adequate cash for the month. The President of the company, who was a non-owner, was out of town on a long weekend and wouldn't be back until Wednesday. The COB (and 100% shareholder) called his attorney with significant concern in his voice, "What could have happened to the money?" he asked. The attorney called on his trusted forensic accountant (even though it was a Friday afternoon on Memorial Day Weekend).

On Saturday morning, a team of forensic accountants arrived on the scene. Together with the COB, they went through the books and records of the company, as well as the office of the President. What they uncovered initially showed that the $500,000 had been sent as a cashier's check to an attorney in another state. Further, there were additional payments being made by the company that did not appear to be authorized or for the benefit of the company, The forensic accountants continued through the weekend and Tuesday morning. By Tuesday afternoon, through the utilization of data extraction software and old-fashioned hard work, they had determined that a total of almost $1.4 million had been spent strictly for the benefit of the president of the company.

During the course of the weekend, other facts were gathered. The president had previously entered a "no contest" plea on a criminal charge of fraud in another state. The underlying issue related to a defalcation of clients funds (the president, although not practicing as such, had previously been a certified public accountant). News articles relating to the prior crime had been located over the weekend and were in the attorney's hands.

Early on Wednesday morning, a meeting was convened with corporate counsel, the HR Director of the company, the forensic accountants and, upon his arrival at the office, the president. The president was escorted into the conference room and an interview was initiated by corporate counsel and the forensic accountant. For almost two hours, the inquiry moved forward very slowly with the president providing information based on what he most likely believed the attorney and the forensic accountant had already determined. After approximated two hours, he asked if he could use the "facilities". He was escorted "to and from" by the guard the company had hired (the guard had also deactivated the president's car upon arrival at the company, without the president's knowledge—it was a company leased car) and when he returned to the conference room he sat down and said: "I guess you probably know almost everything". He then went on to provide information with regard to the majority of the issues that had been uncovered:

- The $500,000 had been sent to an attorney in another state as part of the final restitution requirement of his prior "no-contest" plea.
- The majority of the remainder of the funds (approximately $800,000) that had been spent had been "authorized" by himself as well as by the Controller of the company, and related to items that included maintenance and expansion of

facilities at his private home, cell phones and other accoutrements for his wife, his daughter and two girlfriends, various vacation trips that included in some cases his wife, and in other cases one or more of his girlfriends, and an interesting scheme whereby he obtained bank cashier checks in the amount of $100 and utilizing photo copies of the checks, submitted them as reimbursable expenses for “casual labor”. These totaled almost $80,000 over the course of several years.

The forensic accountants continued working to document all of the background of the various transactions, including whatever invoices or other documentation had been submitted to the company, copies of the front and back of cancelled checks, as well as other documents. The file was assembled and a submission was made to the company’s fidelity bond insurance carrier. After relatively extended discussions and time, the insurance carrier made restitution in the $1 million amount of the fidelity bond. All of the forensic documents were also turned over to the FBI local field agent, and an investigation was started.

Among the issues the FBI was looking into was the fact that the original cashier’s check in the amount of $500,000 was (a) a fraud on the bank by virtue of the misuse of corporate funds and (b) went across state lines with regard to the mailing of the check to the attorney representing the president in his prior criminal defense. The president was subsequently indicted on several federal felony charges and the forensic accountant was notified of his testimony for the criminal trial. (However, this became unnecessary when the perpetrator plead guilty at 5:00 PM that Friday afternoon).

**Update:** The perpetrator is currently serving his sentence at Allenwood Federal Prison.

**The Aftermath:** The Company was subject to this debilitating and drastic fraud because internal controls were not properly in place. The Chairman of the Board had put complete faith in the president whom he had hired. The president used his position to “bully” the controller and other individuals into either approving payments on his behalf, and/or simply looking the other way. While the end of the story would appear to be a $400,000 loss to the company (the original defalcation totaled approximately $1.4 million less the $1 million in fidelity bond insurance recovery) the cost was far greater.

- In addition to the $1.4 million loss, the company incurred almost $100,000 of additional professional fees,
- One week after discovering the defalcation and having had the meeting with the president in the interview as noted above, the chairman of the board died of a massive heart attack which occurred on the floor of the plant and,
- The company was subsequently liquidated.

**Lesson Learned:** The need for proper internal controls and the willingness on the part of top management to review transactions even for a high level COO or president are paramount in order to avoid the potential for disaster.