

The Enemy Within: Detecting and Fighting Administrator Fraud

By Marc R. Lieberman
and Howard D. Sukenic

BY ALL ACCOUNTS, Charlotte was the perfect employee. As the executive secretary to the president of an engineering firm, her duties included opening the mail, paying the bills and processing the paperwork flow to and from her boss. A large portion of this paperwork involved forwarding vendor work invoices to accounting for payment. Charlotte never missed a day's work, rarely took lunch away from her desk and always answered the phone.

It was this combination of opportunity and dedication that allowed Charlotte to steal almost \$1 million from her firm in two years' time.

Keeping Your Eye on the "Right Hand"

What the firm did not know was that Charlotte recently had completed a 10-year prison term for embezzlement prior



to her employment. The firm also did not know that during her two years on the job, Charlotte had made unauthorized charges and cash advances against two corporate credit cards that resulted in her obtaining almost \$1 million in cash and goods.

Her scam worked like this: Charlotte created fraudulent work invoices from established suppliers and forged her boss's signature approving these invoices for payment. These invoices were forwarded to corporate accounting, and a check would be returned to Charlotte payable to the vendor. Upon receipt of these checks, Charlotte would forge the vendor's endorsement and have the checks deposited into the two credit card accounts belonging to her boss. These checks would then satisfy the unauthorized credit card charges and advances Charlotte had run up. Because she controlled the mail, bill payment and all relevant paperwork, Charlotte's scam was almost flawless.

No Crime Is Perfect

Like most administrator fraud, Charlotte's scam relied on her constant control of all the relevant paperwork and communication in the office. That meant she had to be at work every day, all the time, to extinguish any incriminating fires and avoid detection. One day, she reluctantly had to leave work to handle an unavoidable family emergency. As fate would have it, the company's bank called during Charlotte's brief absence, inquiring about a minor charge to one of her boss's credit cards. The boss took the call and promised the bank that they would look into the matter and recontact them. Of course, when Charlotte returned later that day, her boss turned to her to handle the matter. Fearing detection, Charlotte immediately fled to New Mexico.

Victim Assistance Is Essential

When the company finally realized what Charlotte had done, it called the sheriff's department, which assigned an experienced detective to investigate the case. The company also retained the services of a private attorney to monitor the situation. As one can imagine, the case demanded review of numerous documents from the company, its bank, and

Charlotte's bank. An asset search was also essential to find out where Charlotte had moved the stolen money and goods. Finally, all the witnesses had to be interviewed, and Charlotte had to be located, arrested and ultimately extradited.

To assist the authorities, it was imperative that the company quickly provide the following information:

- A chronological narrative of the crime, including a detailed description of each loss
- All identifying information available on Charlotte
- A description of all physical evidence, such as checks and invoices
- The actual physical evidence on hand
- A list of Charlotte's responsibilities, including her written and nonwritten job authority

By quickly collating and providing this information, the company enabled the police to swiftly present the relevant evidence to the county attorney, who immediately filed preliminary charges sufficient to secure an interstate warrant. Armed with the warrant, a detective found Charlotte in New Mexico and brought her back to Arizona. She confessed to everything on the plane ride "home."

Tools of the Trade in the Prosecution of "White-Collar" Cases

A state prosecutor will have an array of charging options in administrator fraud and other "white-collar" cases. In almost every instance, the crime will involve the falsification of documents; therefore, forgery¹ is a typical allegation. Theft² and fraudulent schemes and artifices³ are also charging options. However, the prosecutor must be extremely careful not to mischarge the case. In most employee embezzlement cases, the charge of theft must be employed rather than a charge of fraudulent schemes and artifices.

The genesis for such caution is a result of the Arizona Supreme Court's decision in *State v. Johnson*.⁴ There, the court held that false pretense, created through words or omissions, is the act that separates routine fraud from theft. Specifically, the Court held, "Although breaching a trust relationship may lead to fraud, it does not do so unless the distinguishing element of fraud is present."⁵ To make out a case for fraud, there must

be a scheme for obtaining the property or money by false or fraudulent pretenses,⁶ which is materially different from theft by embezzlement, which occurs when an employee converts, for an unauthorized use, property or money entrusted to him or her for legitimate business purposes.⁷ A prosecutor has to be careful of this distinction, for if a finding of guilt on fraudulent schemes by a jury becomes classified as mere theft by an appellate court, there probably will be no recourse for the State on remand, because jeopardy already has attached.

In an increasing number of administrator crimes, the perpetrator will steal trade secrets or unique items, such as computer microchips, and then sell them on the black market. In these circumstances, trafficking in stolen property⁸ may be charged, which may carry a higher level of felony classification than mere theft. Also, depending on certain factual circumstances, money laundering⁹ and computer fraud¹⁰ may be appropriate charges.

There may even be sufficient facts to charge illegal control of an enterprise/illegally conducting an enterprise.¹¹ In *Baines v. Superior Court In And For Pima County*,¹² the Arizona Court of Appeals listed the essential elements that must be alleged and proved for such a charge: "(1) the existence of an enterprise, (2) the defendant was employed by or associated with the enterprise, (3) he conducted or participated in the conduct of the affairs of the enterprise, and (4) he conducted or participated in the affairs of the enterprise through racketeering, i.e., through the commission of at least one predicate offense."

Another interesting and somewhat "exotic" charge is commercial bribery.¹³ In one case, a midlevel bank manager joined with his counterpart at the Resolution Trust Corporation to solicit kickbacks from vendors of their employers. One of their victims was a sign company (the bank manager and the RTC official controlled all the sign contracts for a particular regional bank under RTC receivership). The sign company immediately contacted the FBI, which, during the investigation, arranged a meeting of the conspirators in a hotel

room wired for video and sound. On the appointed date, the conspirators went to the hotel room, solicited and received the \$45,000 bribe, stuffed the bills in their pockets and headed toward the elevator, where they were arrested. Both individuals were subsequently convicted of commercial bribery in superior court.

Tips on Preparing for and Taking These Cases to Trial

1. Work Closely With the Investigators

It is imperative that the same prosecutor handle the case from investigation through sentencing. A prosecutor will gain great advantage in being able to advise the investigators to ensure a thorough investigation. Furthermore, seeing and understanding the voluminous evidence as it comes in allows the prosecutor to develop a strategy during the investigation that can be aggressively executed the minute an indictment is issued.

2. Develop a Strong Relationship With the Victim

The prosecutor also must develop a strong working relationship with the victimized business. The victim must teach the prosecutor how the business operates, how it maintains its records and the particular protocol the defendant overcame to defeat the system. This is extremely important, because the prosecutor has the responsibility to educate the jury, in layman's terms, as to how the business functions and how the crime was committed. In many cases, few security measures were in place.

3. Get To Know Outside Counsel

A good relationship with outside counsel is also imperative. In many instances, there will be a parallel civil proceeding ongoing during the criminal prosecution. Many relevant witnesses, including, quite possibly, the defendant, will have been deposed. These transcripts are extremely useful tools, and obtaining them from a sympathetic plaintiff's counsel is important.

Getting the Money Back for the Victim

Usually, the money stolen is spent and long gone before the perpetrator is caught and prosecuted. Even a successful prosecution will generate nothing more

than an order for restitution with ridiculously low monthly payments. However, if assets in the defendant's name can be identified, there is a chance that more than just mere pennies on the dollar can be collected. If the appropriate charge is filed, a prosecutor may file a racketeering lien¹⁴ or a restitution lien.¹⁵ These liens can be extremely effective. In one case, a former Illinois judge set up a probate practice in Sun City. He was entrusted with carrying out the last wishes of his clients and to make sure that their estates were handled properly. Many of his clients had no living heirs and left their money to charity. The charities, in most instances, did not know they were beneficiaries.

The defendant took advantage of the situation by closing out the estates and keeping the money for himself. He even stole funds from a conservatorship, which was established by one of his clients for their mentally disabled daughter. Over several years, the defendant stole \$390,238. He used the money to live in grand style, spending more than \$45,000 to landscape his backyard and paying thousands for several classic automobiles. Imposition of restitution liens enabled the state, upon the defendant's conviction, to liquidate almost \$100,000 worth of assets, which were then distributed to the victims.

Avoiding Administrator Fraud: Preventive Tips for the Business Owner

As previously stated, once the damage is done and the thief is discovered, recovering the monies or goods stolen is often difficult. The thief usually has spent most of the funds by the time he is caught, with little in the way of hard assets to show for his efforts. Thus, liens and restitution orders are typically of little use. As a result, unless your business has had the foresight to obtain sufficient fidelity insurance covering the malfeasance of its management,¹⁶ perhaps the best measure for addressing administrator theft is to make sure it never happens or, if it does, that you catch it as quickly as possible. To that end, we make the following suggestions.

First, **ALWAYS** thoroughly investigate the background of the person with whom you are entrusting your company's finances, accounts, books and records. In our first example, a simple

background check would have revealed that Charlotte had spent 10 years in prison and that she was not the best person to be managing the company's bank accounts and payables.

Second, **NEVER** allow just one person to manage and control the finances, accounts and records of your business or firm. If your company does employ a sole administrator to handle billings, collections, deposits and payables, make certain that the administrator verifies, each and every month, the validity of every payable, including all checks written from business accounts and all charges made to business credit cards.

The need for such a regimen is perhaps best illustrated by what is often dubbed the "Bogus Payee" scam. In this con, the administrator opens several bank accounts in which he or she alone is the owner (each with a trade and name similar to that used by businesses regularly transacting with his or her employer). For example, an administrator of a law firm may create several bank accounts, each with the name of a sole proprietorship of a kind with whom the firm regularly does business. One proprietorship might appear to be a court reporting firm, another a supply vendor, and a third a printer. Each month, the administrator writes small checks from her employer to each proprietorship and over several years can accumulate substantial sums without the firm's partners ever having cause to notice. Such malfeasance could be uncovered easily at the outset if the administrator is required not only to produce invoices regularly for all work charged but also to demonstrate that the work charged was actually performed. In one case, the administrator's firm did neither and only discovered her theft when its bank became suspicious due to the large volume of checks being written from the firm's bank accounts to sole proprietorships maintaining accounts with the same bank and owned by the firm's administrator. But for the administrator's error in maintaining the accounts of her fake proprietorships at the same bank with whom her employer did business, her theft might never have been discovered.

Third, **ALWAYS** require two signatures on **ALL** company checks, with one

of those being that of an owner. Many businesses resist such restrictions, choosing instead to require only two signatures for amounts in excess of a reasonable dollar limit, say \$2,500 or \$5,000. Such high limits merely cause criminal administrators to commit their fraud by writing checks to themselves or fictitious companies for amounts less than the two-signature minimum. For this reason, only requiring two signatures on high dollar amounts is a mistake and should be resisted. One caveat, however: The authors have discovered that many financial institutions ignore the two-signature requirement, allowing administrators alone to write checks on company accounts for amounts far in excess of those authorized for a single signatory. Therefore, companies are urged to remind their banks of such restrictions periodically, preferably in writing.

Fourth, **EACH** year, and preferably each quarter, have an independent accountant (preferably a CPA) audit the firm's payables and receipts to ensure that each is in relative balance. Urge the auditor to press the administrator to prove the validity of each payable, and

question carefully all receivable write-offs. For example, in another typical ploy, the "Third Party Discount Con," an administrator opens a bank account under her maiden name (Ms. X); she then advises debtors of her company that they can receive a substantial discount on their individual bills if they will pay a small portion of their bill immediately to Ms. X, advising that the firm owes Ms. X substantial sums. Meanwhile, the administrator explains away the discounts provided to the company's debtors on the grounds that such discounts were necessitated by market forces. All too often, management never questions such explanations, to its peril.

Finally, pay your administrator well. A well-paid, well-treated administration is less apt to bite the hand that feeds it.

Conclusion

Charlotte was convicted of fraudulent schemes and artifices, a Class 2 felony. Because she had two prior felony convictions, she was sentenced to 15.75 years and ordered to pay \$946,318 in restitution. Most of the money was gone, having been spent by her on worthless

items. It is unlikely that Charlotte ever will be able to comply with the restitution order, at least not through lawful means.

There is no foolproof method for detecting or preventing administrator theft, for a clever administrator usually will be able to defeat any system. However, regularly challenging administrator actions and procedures will let your administrator know that the company is not a pushover and that the administrator does not have carte blanche to steal the company blind. That may discourage all but the boldest of thieves, and, for them, only regular review of their work and good police work may uncover and punish their crimes. ♣

Marc R. Lieberman is a principal in the Phoenix law firm of Lieberman, Dodge, Gerding, Kothe & Anderson, Ltd. He has significant experience with cases concerning employee dishonesty and administrator fraud. Howard D. Sukenic is a Deputy County Attorney serving in the Special Crimes Bureau. His practice is devoted to the prosecution of Russian organized crime, insurance fraud and other "white-collar" crimes.

ENDNOTES

1. A.R.S. § 13-2002. Forgery: A person commits forgery if, with intent to defraud, such person:
 - A. Falsely makes, completes or alters a written instrument; or
 - B. Knowingly possesses a forged instrument; or
 - C. Offers or presents, whether accepted or not, a forged instrument or one which contains false information.
2. A.R.S. § 13-1802 Theft.
3. A.R.S. § 13-2310. Fraudulent schemes and Artifices; classification; definition (hereafter fraud)
 - A. Any person who, pursuant to a scheme or artifice to defraud, knowingly obtains any benefit by means of false or fraudulent pretenses, representation, promises or material omissions is guilty of a class 2 felony.
 - B. Reliance on the part of any person shall not be a necessary element of the offense described in subsection A.
 - C. As used in this section, "scheme or artifice to defraud" includes a scheme or artifice to deprive a person of the intangible right of honest services.
4. *State v. Johnson*, 179 Ariz. 375, 880 P.2d 132 (Ariz. 1994).
5. 179 Ariz. at 379, 880 P.2d at 136.
6. *State v. Haas*, 138 Ariz. 413, 675 P.2d 673 (Ariz. 1983).
7. Theft is a single unified offense, even though the theft statute (A.R.S. § 13-1802) has multiple subsections, of which embezzlement is just one. *State v. Winter*, 146 Ariz. 461, 760 P.2d 1228 (Ariz. Ct. App. 1985). The basic elements of embezzlement are explained in *State v. Leeman*, 119 Ariz. 459, 581 P.2d 693 (Ariz. 1978).
8. A.R.S. § 13-2307(B). Trafficking stolen property; classification
 - A. A person who knowingly initiates, organizes, plans, finances, directs, manages or supervises the theft and trafficking in the property of another that has been stolen is guilty of trafficking in stolen property in the first degree.
9. A.R.S. § 13-2317.
10. A.R.S. § 13-2316.
11. A.R.S. § 13-2312.
12. *Baines v. Superior Court In and For Pima County*, 142 Ariz. 145, 149, 688 P.2d 1037, 1041 (Ariz. Ct. App. 1984).
13. A.R.S. § 13-2605. Commercial Bribery
 - A. A person commits commercial bribery if:
 1. Such person confers any benefit on an employee without the consent of such employee's employer, corruptly intending that such benefit will influence the conduct of the employee in relation to the employer's commercial affairs, and the conduct of the employee causes economic loss to the employer.
 2. While an employee at an employer such employee accepts any benefit from another person, corruptly intending that such benefit will influence his conduct in relation to employer's commercial affairs, and such conduct causes economic loss to employer or principal.
14. A lien is a charge, security or incumbrance upon property (*Black's Law Dictionary* 1072, 4th ed., 1968). A racketeering lien is one that can be filed by the state only in connection with a racketeering action under § 13-2314. In accordance with A.R.S. § 13-2314.02, the filing of a racketeering lien creates a lien in favor of the state in:
 1. Any interest of the defendant, in real property situated in the county in which the lien is filed, then maintained or thereafter acquired in the name of the defendant identified in the lien.
 2. Any interest of the defendant in personal property situated in this state, then maintained or thereafter acquired in the name of the defendant identified in the lien; and
 3. Any property identified in the lien to the extent of the defendant's interest therein.
15. A restitution lien is one that can be filed by the state or any person entitled to restitution pursuant to court order (A.R.S. § 13-806).
16. A good rule of thumb is to obtain fidelity insurance for twice the amount of money to which the administrator has access, because nearly all policies charge the cost of investigation and prosecution against the covered amount. Fidelity insurance is relatively inexpensive and can be the only reliable method of recouping much of what an administrator has taken. However, be aware of the "entrustment" exclusion in most policies, which excludes coverage for amounts or goods stolen that were actually entrusted to the administrator's care. Thus, if you authorize your administrator to deposit \$10,000 cash into the company bank account and instead she deposits the cash into her personal account, the entrustment exclusion may preclude coverage for such theft.