

# Currency Transaction Report

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# FINANCIAL INVESTIGATION and FORENSIC ACCOUNTING

## Second Edition

George A. Manning, Ph.D., C.F.E., E.A.

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- 26 Cash In \$ \_\_\_\_\_
- 27 Cash Out \$ \_\_\_\_\_
- 28 Date of Transaction M M D D Y Y
- 29  Foreign Currency \_\_\_\_\_ (Country)
- 30  Wire Transfer(s)
- 31  Negotiable Instrument(s) Purchased
- 32  Negotiable Instrument(s) Cashied
- 33  Currency Exchange(s)
- 34  Deposit(s)/Withdrawal(s)
- 35  Other (specify) \_\_\_\_\_
- 36  Other (specify) \_\_\_\_\_

### Part III Financial Institution Where Transaction(s) Takes Place

Enter Federal Regulator or BSA Examiner code number from the instructions here. ▶

39 SSN or EIN

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# **FINANCIAL INVESTIGATION and FORENSIC ACCOUNTING**

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**Second Edition**

**George A. Manning, Ph.D., C.F.E., E.A.**



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# Dedication

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*In Loving Memory, to my wife, Lois E. Manning,  
who passed away suddenly in 2002.  
She was a very loving and devoted wife and mother of two children.*



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# Preface

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Forensic accounting can be defined as the science of gathering and presenting financial information in a form that will be accepted by a court of jurisprudence against perpetrators of economic crimes.

Economic crimes have increased dramatically in recent years. This becomes evident in viewing newspaper reports, which on an almost daily basis report of economic crimes committed in communities across the country. One can read of a person embezzling funds from a bank or company, a political person accepting kickbacks for political favors, a con artist who swindles people out of money by fraudulent schemes, or a person selling illegal products (drugs, alcohol, or tobacco).

Law enforcement personnel in recent years have become more aware of white-collar crimes. However, they have lacked the training and expertise in combating such crimes. This is particularly true for small police departments. The law enforcement community today is better trained at combating violent or personal behavior crimes, but now it has the responsibility to expand its knowledge and expertise into the economic crimes area. In order to do this, law enforcement must receive further education and training. Many police departments, both small and large, focus their resources on violent crimes. Since many detectives do not have an accounting background, they often fail to use financial information to support their cases. This is particularly true in organized crime and drug trafficking cases. Congress and some states have enacted laws for law enforcement to use financial information to support their cases. Some large police departments have employed accountants to help law enforcement develop financial information, but they are relatively few. One South Florida police department with over 2000 sworn officers has only one accountant, and he is swamped with cases. Some police departments will contract an accountant for a case, but this is rare.

The accounting profession is beginning to change from examination for irregularities to examination for fraud on the part of employees and management. Some of the largest bankruptcies have occurred during the last 5 years because management has been “cooking the books” to hide their skimming of huge amounts of funds from public corporations. This has resulted in many investors losing their life savings or retirement nest eggs. This, of course, has resulted in a change of audit procedures to encompass external third-party inquiries as well as internal audit procedures. Financial institutions and credit reporting agencies are becoming more involved with business organizations’ financial affairs by requiring more disclosures. They are developing more techniques to uncover potential fraudulent schemes by developing profiles, which will identify perpetrators before huge losses are incurred by other businesses.

The cooperation of accountants and law enforcement has now become not just important but imperative. Accountants must know what financial data are admissible in a court

of law. The criminal investigator must learn how to use financial information to enhance his case.

The following illustration gives an example of what the results can be when law enforcement personnel do not have the training and knowledge to use financial information.

A police department in South Florida obtained a search warrant for a car dealership suspected of dealing in drugs. The officers went in and discovered large amounts of cocaine, money, jewelry, precious metals, and financial files. The police officers confiscated the cocaine, money, jewelry, and precious metals, but left the financial files behind. In a forfeiture hearing, the defendants claimed that the jewelry and precious metals did not belong to them and provided witnesses who testified that the jewelry and precious metals were being held on consignment. The court ruled in favor of the defendants, and several days later, the defendants got on a flight out of the country with the jewelry and precious metals in their possession. It was later learned that the jewelry and precious metals were purchased from various vendors in the city. The estimated cost of the jewelry and precious metals was \$1.8 million. The drug traffickers removed their laundered money out of the country by buying jewelry and precious metals since no Treasury Currency and Monetary Instrument Reports (CMIRs) were required at the time. The police would not have lost the jewelry and precious metals if they had confiscated the financial records, which clearly showed how the defendants purchased the commodities.

Accountants in both public practice and industry must recognize financial crimes at an early stage and document such crimes for judicial prosecution. Most accountants do not recognize fraud. Business people do not recognize fraud schemes until it is too late. The following illustration shows how a business became a victim even when advised of the situation.

A major supplier of appliances had a policy of granting liberal credit terms to new businesses. A new appliance store took advantage by ordering a nominal amount of appliances. The new store regularly ordered appliances at an increasing rate using the liberal credit terms. The controller noticed that the rate of increase was above normal. The management of the supplier disregarded the controller's concern. After about 9 months, the new store placed an \$800,000 order, and since the new store paid its bills on time, the order was shipped. The management of the new store received the \$800,000 order and the next day shipped its entire inventory to another location some 300 miles away. When the supplier sent notices to the new store for payment, the notices first came back marked "unclaimed" and later came backed marked "moved with no forwarding address." When the supplier sent collectors out to the new store, they found the building empty. The new store owners disposed of the inventory for \$1.5 million and the supplier suffered a loss of \$800,000, which took 5 years to recover by raising prices by 10%. The supplier unsuccessfully sued the new store. Law enforcement would not proceed against the store owners because they concluded that the new store owners were merely bad businessmen. Actually, law enforcement did not know how to prosecute this kind of crime.

The purpose of this book is twofold. First, it should be used as a reference guide by law enforcement and accountants. This book is written so the reader can find specific issues and learn how to investigate and present them in a court of law. Second, it can be used as a textbook in training both law enforcement and accountants in the field of fraud examination and forensic accounting.

This book is focused upon practical, everyday use by both law enforcement and accountants. Theory is also addressed, but it is explained more in terms of everyday use. Another objective is to make accountants familiar with law enforcement and the law, and law enforcement familiar with the importance of financial information in both civil and criminal cases. It has been made very clear that when a team of both accountants and criminal investigators team up, they rarely lose a criminal case. Also, they learn the inter-relationships and needs of each other.

A trend across this country today is the declining budgets of law enforcement agencies at all levels of government. At the same time, violent crime is on the increase and is expected to increase much more in the future. Public opinion today is for law enforcement to go after violent criminals. Violent crime is on television every day, but white-collar crimes are rarely reported. If this trend continues, then law enforcement will be unable to provide the personnel and other resources needed to investigate white-collar criminals. The FBI reported in the 1990s that violent crime makes up 95% of all cases, while white-collar crime only makes up 5%. Yet, white-collar crime is responsible for 95% of the financial losses suffered by victims.

The security industry has had tremendous growth in recent years. It has made a great demand for security locks, various types of alarms, and security guards. Private investigation firms have also shown tremendous growth, particularly in matters relating to civil litigations, searching for hidden assets, and tracing funds. Some law enforcement agencies have retained private fraud examiners in their investigations. If this trend continues, and the outlook is that it will, fraud examiners will be in greater demand in the future.





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# The Author

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## 1.1 Introduction

The effects of crime act upon the economy in two primary ways. Microeconomics deals with the effect on individuals and businesses. Macroeconomics deals with the effect on the local community, national, and international economies. Individuals and businesses can easily understand the effect of crime in their everyday activities. However, most individuals and businesses have difficulty understanding the effect of crime on the community, national, and international levels.

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## 1.2 Cost Reality

The cost of crime on the economy in the U.S. is now at a staggering height. The outlook does not look any better. There is no real compensation for emotional and social harms done to members of a society by criminal acts. The average citizen would be shocked to know the actual costs. There are no consolidated figures as to the total cost of crime. However, if all the various costs were compiled into a consolidated figure, then they would surely be enormous. The cost of crime involves all of the following elements:

1. **Law enforcement.** This encompasses the cost of training and maintaining a police department and all of its support staff, equipment, buildings, etc.
2. **Crime prevention.** This involves all the community programs that try to help prevent crime. Common programs include Crime Stoppers, school programs, and various other programs sponsored by local community tax dollars.
3. **Drug prevention and rehabilitation.** This involves both public and private financing. Both government and private organizations offer programs to prevent and rehabilitate drug and alcoholic offenders. This costs money to both the taxpayers and the patients.
4. **Incarceration.** It costs the taxpayers a lot of money to house, supervise, train, feed, clothe, and provide medical care for inmates in a jail or detention center.
5. **Courts.** Operating and maintaining the court system costs the taxpayers many tax dollars. It involves judges, court reporters, clerks, buildings, etc.

6. **Prosecutors.** The costs of employing prosecutors and their staffs, buildings, and all of the associated costs of operating and maintaining them are enormous, especially in large metropolitan areas.
7. **Public defenders.** Many defendants are not able to afford defense attorneys; therefore, the taxpayers must foot the bill. This bill includes costs of defense attorneys, their staff, and all the costs of operating and maintaining them.
8. **Hospitalization.** A significant cost to society as a whole is health care costs. Medical costs for criminals, victims, and those involved in the justice system are a significant item. With the increase in AIDS and other diseases, this cost has become even more of an attention getter.
9. **Businesses.** Businesses suffer losses when customers or employees steal from them. They have to raise prices or lay off employees because of thefts.
10. **Insurance companies.** Individuals and businesses that have insurance file claims for losses that they suffer from crime. This, in turn, causes insurance companies to raise premiums to individuals and businesses.

The cost of crime can be very high. Some people say that some types of crime do not cost society, i.e., illegal gambling and prostitution. However, you can see that it does cost society. Let us take an example of a simple case. A bookmaker takes bets from his bettors. It is illegal in his area. The bettors are not forced to place bets. They place wagers because they want to “place their money where their mouth is.” Most bettors are middle-class workers. The bookmaker pays off the winners and collects from the losers. When law enforcement makes an arrest after considerable investigation, they must put the bookmaker in jail. The bookmaker usually posts bond or bail and is out after a short period. The bookmaker claims poverty and must retain a public defender. The case goes to trial and the bookmaker is found guilty. He is sentenced to 60 days in the county jail.

The cost to society in terms of money in this example is high. First, the bettors who placed the bets should not have placed bets, since they were using their hard-earned money that should have been used to pay their living expenses. It costs money to the taxpayers to pay the salaries of the investigators and their supporting staff to look into the bookmaker. In addition, it costs taxpayers money to try the bookmaker in court. The judges and their staff have to draw salaries and pay for their expenses. It costs taxpayers even more money to house the bookmaker in jail. The taxpayer has to pay for food and medical costs while the bookmaker is in jail. Also, jailers and correction officers must be paid, along with their benefits, to guard the bookmaker while he is in jail. It costs taxpayers for the detention facilities. The public defender must be paid from public funds. One can see that it costs society in dollar terms even though there is no violence. This example can apply to other “victimless” crimes, i.e., traffic violations, prostitution, and other misdemeanors.

### 1.3 Microeconomics

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This segment of economics deals with individuals and businesses. The primary effect is the direct loss of money or property by the victim. In most cases, the dollar amount of money or property can be determined after the commission of the crime. In other cases, this may not be true. There are a few crimes where the reputation of the victim is damaged. The victim usually suffers a loss. Any person or business can become a victim. The cost to the victim can be enormous, or there can be no economic loss. The costs to the local

community and the nation can be enormous when considering the total costs. The following examples of crimes show how victims can suffer a loss.

### **1.3.1 Arson**

This crime can affect both the victim and the insurance company. If the victim has no casualty insurance coverage, then the business or individual will undoubtedly be put out of business or home if the owners do not have the capital to rebuild. If the victim has insurance, then the insurance company has to pay the claim. If the casualty is caused by the victim in order to collect insurance, then the insurance company can refuse to pay and the victim will normally suffer the loss. In either case, one or the other, or both, will realize a loss of property or money.

### **1.3.2 Bankruptcy Fraud**

This crime affects the creditors of a business. They ship goods to a customer with the expectations of receiving payment on agreed terms. The customer diverts the goods elsewhere and does not make the payment. The creditor suffers a loss of not only the cost of the merchandise but also the gross profits. For small businesses, this can be devastating. They are usually not able to recover the losses. For larger businesses, they pass the loss, which could take weeks, months, or even years to recover, on to other customers by raising their prices.

### **1.3.3 Forgery and Uttering**

This crime usually involves writing bad checks or cashing stolen checks. The amount of the loss is the amount of the check(s) involved. This crime also involves the criminal submitting false or forged documents to obtain a financial gain.

### **1.3.4 Larceny**

Larceny is also called theft. It involves the criminal taking of property from a victim. The value of the property is the economic loss incurred by the victim.

### **1.3.5 Identity Theft**

This crime involves using the identity of the victim to obtain financial gain. The criminal uses the victim's Social Security number or driver's license number to obtain credit. The criminal uses credit to obtain goods and services. The goods and services are not paid by the criminal. The creditors try to get the victim to pay the bills. Even though the victim does not have to pay the bills, it ruins the credit standing of the victim. In this case, the creditors suffer the economic loss.

### **1.3.6 Loan Sharking**

The borrower pays interest at a very high rate. Usually, the interest is so high that the borrower can never get the principal reduced. As a result, the loan shark may use violence against the borrower, which in turn results in the borrower getting further behind on his payments because of additional bills, e.g., medical expenses. In the case of organized crime, the borrower may be forced to commit some other act, usually economic, which will either repay the lender or help the lender to get some economic advantage.



### **1.3.7 Credit Card Fraud**

Most stolen credit cards are stolen before they reach the intended customer, although many credit card numbers are stolen by store cashiers or other store employees. In some cases, credit cards are counterfeited, sometimes using legitimate numbers. Stolen credit cards are used to purchase merchandise that is fenced to an illegitimate vendor. The vendor in turn sells the merchandise for cash. The cardholder is not liable for the purchases if he reports the theft to the credit card company within 30 days. This requires the cardholder to review his statements every month. After he discovers that his card is stolen, he is still out some money, usually \$50 after the credit card company is notified. One organized crime group ships the goods overseas for resale. Credit card companies report that they lose multiple millions of dollars through credit card fraud. This is the primary reason for them charging high interest rates of 14 to 18%, or even higher in some states.

### **1.3.8 Mail-Order Operations**

This crime occurs when a customer sends money to a mail-order house for the purchase of merchandise and the mail-order house does not send the merchandise, but pockets the money. This is called a “boiler room” operation. Some states have required licensing of telemarketers. This has not prevented or deterred these operations, but it has made it somewhat easier to track down corrupt telemarketers by law enforcement.

### **1.3.9 Medicare/Medicaid Fraud**

This crime involves health professionals obtaining Medicare/Medicaid numbers from patients. The health professionals submit false claims to the government for goods and services not provided to the patient. This is fraud against the government.

### **1.3.10 Repair Fraud**

This crime involves various types of repairmen who either do not fix the item needing repair or charge for services not performed. The victim suffers a loss by the amount charged by the repairman.

### **1.3.11 Skimming/Embezzlement**

Skimming involves the diversion of business receipts from the business, in effect stealing from the business and the government. The owner of the business is usually trying to hide money from either the tax collector or a partner. Embezzlement is the stealing of money from the employer. The economic loss is the amount of funds diverted or stolen.

### **1.3.12 Stock Manipulation**

Stock manipulation is the transfer of stock between related entities or people in order to increase the market value. When the value is high, normally far above the market value, the stock is sold to other investors. Later, the value of the stock or bonds drops to the actual market values. The investor later suffers a loss measured by the cost less the amount realized when sold.

### 1.3.13 Swindlers

The perpetrators of this crime are often referred to as con men. The word *con* is short for confidence. The criminal gains the confidence of a victim. When the con man has a victim's confidence, then he or she will take money or property from the victim and disappear. The economic loss is determined by the amount of money or property lost by the victim.

### 1.3.14 Narcotics

The use of narcotics by consumers has devastating effects at both the micro- and macro-economic levels. This section deals with the microeconomic level. First, narcotic use diverts consumers' funds to narcotics, instead of for everyday living expenses. The narcotic user becomes addicted, which drives the user to want to buy more and more. After a time, the narcotic user will use all his resources to purchase the illegal substance. Crack cocaine is one narcotic that will do this in a relatively short time. There is no such thing as a casual drug user. The narcotic user will eventually do anything to get funds to purchase more narcotics. The user's performance on his job drops and absenteeism increases. Eventually, the user will lose his job. In some instances, he will steal from his employer and may get caught. Narcotics users would rather pay for narcotics than for their living expenses. When they lose their jobs, they resort to borrowing and stealing from others.

The street pusher, who sells the narcotics to the consumer, is usually a user himself. If not, the pusher is trying to make money in order to get out of his economically depressed state. Street pushers have been found to be as young as 12 years old. In recent years, criminal organizations like to have kids do their drug pushing because they do not serve time in jails or correctional centers. Also, they have an easy market for drugs because they can sell to elementary, middle, and high school students.

The drug kingpins reap the major profits from drug trafficking. They usually do not use or possess any drugs. They control and direct the shipments and distribution of drugs. A major part of the profits goes to the drug kingpins. This, in effect, causes the wealth of a community to become concentrated from the many to the few. In small communities, this can be readily evident by observing who the wealthy people are in the community and by their occupations or business ventures. In metropolitan areas, this is not so evident because of the intermingling of wealthy people from both legal and illegal business ventures.

## 1.4 Macroeconomics

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Macroeconomics deals with the local community (city or county), regional, national, and international levels. Academia is interested in the economic aspects of crime. Law enforcement is also interested. Large metropolitan police departments monitor crime areas in order to move resources to combat it. Various federal agencies have economic or statistical units. These units keep track of various types of crimes.

### 1.4.1 Organized Crime

Organized criminal organizations operate at both the micro- and macroeconomic levels. Legally speaking, organized crime is defined as three or more individuals. Actually, they range from a handful to thousands of members. These individuals usually operate as a

group. Their main goal is financial gain. In some organizations, power is another goal. Organized crime provides the biggest threat to local communities and the nation.

The magnitude of organized crime, as measured by its income, continues to be of much debate. James Cook, *Forbes Magazine* (1980), estimated that organized crime is a large and growing part of the national economy. He projected that its income was over \$150 billion annually. Cook based his estimate on gross criminal income by types of activity taken from various original sources. However, as reported by The President's Commission on organized crime, Peter Reuter (1983) believed Cook's estimates were too high by a factor of four. Cook asserted that organized crime was the second largest industry in the U.S. during 1979. The Wharton School of Economics conducted an independent study of the income of organized crime using new data sources on the number of persons engaged in organized criminal activities and on the average income of people involved with criminal organizations. The data were collected from law enforcement agencies and from a sample of 100 IRS tax cases involving members of criminal organizations. Wharton estimated that gross receipts ranged from a high of \$106.2 billion to a low of \$65.7 billion. It also estimated that net income ranged from a high of \$75.3 billion to a low of \$46.6 billion. Wharton indicates that organized crime is a major industry. Wharton's income estimate of \$47 billion in 1986 equals 1.13% of the U.S. gross national product. It estimated that organized crime employs at least 281,487 people as members and associates, with the projected number of crime-related jobs over 520,000.

Manufacturing and mining operations are the only major industries that do not appear to be heavily infiltrated. A major concern with organized crime involvement in legitimate industries is that threats and intimidation may be used to limit competition and obtain excessive profits. The measurable result of such activities is higher prices. Taxes are not paid on much of the income generated by organized crime; implicitly, this results in higher taxes being imposed on the incomes of other citizens to make up for this loss in tax revenues. Based on the lower-level estimate of organized crime income (\$29.5 billion) and the assumption that taxes are not paid on 60% of this criminal income, it is estimated that personal taxes on other citizens were \$6.5 billion higher than would be the case if all organized crime income were taxed.

Most studies often used in organized crime do not actually relate to organized crime. Most of the income estimates are for all types of criminal activity and include much more than organized crime. The other common characteristic of most studies is a focus on illegal activities, especially drugs and gambling. Less attention is paid to the other side of organized crime: its involvement in legitimate businesses and labor unions. As a result, part of the income of organized crime is not counted and part of its impact on society, through its infiltration of the legitimate economy, is missed. It is known that organized crime involvement in the legitimate economy is increasing. Previous studies were used and updated. In some cases, new data were obtained and used for the 1986 report to the President's Commission on Organized Crime.

#### **1.4.1.1 Local Industries**

In the local community, organized crime operates many businesses, legal and illegal. Organized crime likes to operate illegal activities in communities as follows:

- Prostitution
- Gambling
- Narcotics trafficking

- Trafficking in stolen goods
- Auto theft and repairs
- Extortion
- Illegal liquor making or distribution
- Trafficking in tobacco

Local businesses that organized crime likes to operate in the legal arena are:

- Construction
- Waste removal
- Garment industry
- Food processing, distribution, and retailing
- Hotels
- Bars
- Banking
- Business and personal services
- Legalized gambling
- Liquor retailing and wholesaling
- Entertainment
- Motor vehicle sales and repairs
- Real estate
- Other cash-oriented businesses

It likes to operate these businesses for three reasons. First, it can launder its illegal profits through a legitimate business. Second, it can skim profits by various methods. Last, if organized crime can obtain a monopoly in the area, then it can get higher prices for its products and services. This results in greater profits.

**1.4.1.1.1 Construction.** Organized crime likes the construction industry, particularly in major metropolitan areas, because it can get profits through “ghost” (nonexistent) employees, extortion, and control of materials. For contractors to get jobs, they must employ ghost employees, pay kickbacks, and pay higher prices for raw materials. All of these costs are passed down to the consumer in the form of higher prices for goods and services, higher rents, higher taxes, and other costs.

**1.4.1.1.2 Waste Removal.** Organized crime affects the waste removal industry by controlling either labor or the dumping sites. Labor unions are a favorite target for organized crime since it can gain from exploiting labor. The labor is mostly uneducated, and therefore an easy target. Either dumping sites are owned by criminal organizations that charge excessive charges or wastes are simply dumped at unsuspecting sites without the permission or knowledge of the property owners.

**1.4.1.1.3 Motor Vehicle Sales and Repairs.** Organized crime deals a lot in motor vehicles in several ways. First, it steals vehicles and transports them to other states where they are sold to unsuspecting customers. Second, it likes to use repair shops to sell parts from stolen cars that were previously obtained from “chop” shops. These parts are sold at new-part prices.

**1.4.1.1.4 Cash Businesses.** Organized crime particularly targets cash businesses, e.g., bars, restaurants, hotels, package stores, convenience stores, etc. First, it can easily launder its illegal profits. Second, it is susceptible to skimming and embezzlement. People who do not like to pay taxes particularly like cash businesses since records are not usually kept.

## **1.4.2 Data and Statistics**

In the U.S., crime statistics are compiled by the Federal Bureau of Investigation (FBI). The Uniform Crime Reporting (UCR) Program was conceived in 1929. In 1930, the FBI was tasked with collecting, publishing, and archiving those statistics. Today, the FBI publishes an annual statistical report called "Crime in the United States." The data are provided by over 17,000 law enforcement agencies across the U.S. It also publishes other annual reports that address specialized facets of crime. Additionally, the FBI publishes specialized reports using data from the UCR Program. One of these specialized reports is "The Measurement of White Collar Crime Using Uniform Crime Reporting Data."

The UCR annual reports provide data as to:

- Murder and nonnegligent manslaughter
- Rape
- Robbery
- Aggravated assault
- Burglary
- Larceny/theft
- Motor vehicle theft
- Arson

The UCR reports provide the number of total offenses by state and by age groups. The reports also provide data as to victims, number of arrestees, and cases closed. It must be kept in mind that the data provided are crimes reported to law enforcement. Many white-collar crimes are not reported to law enforcement. Businesses that suffer losses from embezzlement sometimes do not report the crime. Instead, they just fire the person. Individuals sometimes do not report offenses for various reasons.

### **1.4.2.1 National**

Using the UCR reports, one can determine the economic loss. However, the economic loss is computed for the direct loss of property stolen. In general, the value of the property is determined by assigning fair market value to depreciated items and replacement costs to new or almost new items. However, credit cards and nonnegotiable instruments are submitted with no value associated with them. The economic costs of incarceration, trial, and imprisonment are not taken into consideration. For example, the economic loss due to embezzlement would be done by finding the number of embezzlements and the average value of funds taken. In 1999, the number of embezzlements was 21,356 reported. The average value was \$9,254.75. The result is a loss of \$197,644,441.00 ( $21,356 \times \$9,254.75$ ) nationwide.

### **1.4.2.2 State**

The UCR reports provide data by state. Using the data provided, one can extrapolate the loss by embezzlement at the state level. The result for Florida is \$8,264,491.75 (893 × \$9,254.75) statewide in 1999. In this illustration, the average loss for the state of Florida was not given, so the national average was used. The highest crime state as reported by the UCR reports is California, while Delaware had the smallest crime rate in 2002.

### **1.4.2.3 International Statistics**

Most industrialized countries keep statistics on crime. The International Criminal Police Organization (Interpol) publishes annual international crime statistics. It maintains information on offenders, drug seizures, counterfeiting, and stolen property. Its data comes from various national police agencies that are members of Interpol. At present, there are 166 member countries. The United Nations Office on Drugs and Crime publishes an annual report on drug production, trafficking, and consumption. Not all countries report. One reason is that some countries do not keep statistics on crime and drugs.

## **1.4.3 International**

Macroeconomics deals not only with national economic policies, but also with the international economic arena. This section deals with the international impact of organized crime. International organized crime is almost solely involved in narcotics trafficking; however, this is changing. Basic narcotics substances are produced in one country and exported to another country where they are sold for huge profits. A lot of the huge profits are returned to the country where the narcotic substances are produced. These profits are used not only to acquire wealth, but also to acquire power, which can be almost as great as the government itself.

### **1.4.3.1 Cocaine**

Cocaine production has a great impact on South and Central American countries. Coca plants are grown, harvested, and sold to the drug lords who produce coca paste. They not only produce the coca paste, but sometimes carry the production down to pure cocaine powder. The cocaine is shipped to other countries, principally the U.S., where it is sold. The profits are then smuggled back to the country of origin and invested in the local economy.

**1.4.3.1.1 Mexico.** Mexico has become in recent years the largest supplier of cocaine and marijuana to the U.S. The U.S. has complained to the Mexican government that they are not doing enough to stop the drug trafficking and has even accused their law enforcement agencies of corruption. It was not until the brutal murder of Enrique Camarena, a U.S. DEA agent, in February 1985 that the Mexican government began getting some heat. However, it was not until the murder of *Excelsior* columnist Manuel Buendia, who was shot and killed, that the Mexican government began to take action. In June 1990, the Mexican government finally acted, arresting the chief of domestic intelligence, Jose Antonio Zorrilla Perez, and four other members of the National Security Directorate, a combination of the CIA and the FBI. Prosecutors charged that Zorrilla killed Buendia because the reporter learned that Zorrilla was protecting top drug traffickers. The allegations of drug trafficking or protection involved a former defense minister, two brothers of the governor

of Baja California Sur, and the cousin of a former president. In addition, the Mexican government arrested a drug kingpin known as the godfather, Miguel Angel Felix Gallardo. It is well known that drug profits went not only to these officials, but also to others who have not been identified. Mexico has provided a classic case that drug profits corrupt public officials at all levels.

**1.4.3.1.2 Costa Rica.** Even though Costa Rica is not a producer of cocaine, it does have the means to be an attractive money launderer of cocaine profits. In addition, it serves as a transshipment point from South America to the U.S. The U.S. warned Costa Rican officials of their position of being a laundering alternative. A Costa Rican commission in 1988 concluded that drug traffickers influenced all three branches of the government. Former government officials were accused of links to drug traffickers, and some were even charged and arrested. A drug trafficker, Roberto Fionna, was arrested who previously was able to get legal residence through his political connections.

**1.4.3.1.3 Guatemala.** Guatemala is a big producer of opium poppies (the raw material for heroin) and a transshipment point for cocaine bound for the U.S. Mexican drug traffickers who lined up with left-wing guerrillas to protect growers of poppies control large geographical areas. This resulted in the Guatemalan police's refusal to enter the areas. In recent years, Guatemala has become active in cocaine production and corruption is increasing.

**1.4.3.1.4 Honduras.** Honduras is an important transshipment point for Colombian cocaine. It is also a growing center for money laundering. In 1989, Honduran authorities arrested Juan Ramon Mata Ballesteros, a cocaine kingpin, and expelled him to the U.S. This has sparked antigovernment and anti-American demonstrations. The corruption of public officials is not countrywide, but has been limited to area or district-level military officials.

**1.4.3.1.5 Panama.** Prior to the U.S. invasion of Panama, General Manuel Noriega was indicted by U.S. District Courts for drug trafficking and money laundering. Top Panamanian military officers were living far above their means. This source of wealth was from drug trafficking or money laundering. It was alleged that General Noriega had stashed \$200 million in various bank accounts. When the Bank of Credit and Commerce International was seized by U.S. law enforcement agents in the U.S., it was discovered that nearly half of the assets in the Panamanian branch belonged to General Noriega. The U.S. invaded Panama in December 1989. The findings have not been fully disclosed at this time; however, newspaper accounts have indicated that corruption was very widespread.

**1.4.3.1.6 Bolivia.** Hundreds of thousands of Bolivians are involved in growing, making, or distributing cocaine. Drugs account for \$300 to \$500 million in the economy. The total exports total only \$600 million from legal goods or services. Vast areas of Bolivia are not patrolled by the police, so traffickers are able to fly cocaine to Colombia or Brazil without any interference. Corruption is rampant. In 1980 the right-wing government was installed by the military, who were backed by drug traffickers. The Bolivian interior minister is under indictment in Miami on drug trafficking charges.

**1.4.3.1.7 Brazil.** Brazil is a vast country. With unguarded borders and underpaid police, it has had alarming increases in shipments and processing operations. Colombian cartel bosses have for many years spent vacations there, and they began their work in the jungles as early as 1984. The growing of coca is greatly increasing. It is expected that Brazil will become a major coca producer in the years ahead.

**1.4.3.1.8 Ecuador.** This country is a minor producer of coca. However, it is becoming an important center for drug trafficking and money laundering. Shipments to the U.S. and Europe from Ecuador have had cocaine hidden in various merchandise, such as handicrafts, canned goods, and wood products. Officials have reported that Colombian drug traffickers launder from \$200 to \$400 million through Ecuador every year. Newspapers have expressed concern about the corruption of government officials by drug cartels. In one case, two judges signed an order for the release of a drug trafficker from jail. The judges fled when people made an outcry. One judge was captured with about \$20,000 in cash. The other judge and drug trafficker are still at large.

**1.4.3.1.9 Peru.** The most potent coca plants are produced in Peru. Most of the coca plants are grown in the Huallaga Valley, which is northeast of Lima. This area is controlled by Colombian cocaine producers and distributors. In addition, the drug traffickers have formed an alliance with the Shining Path guerrillas to unite their efforts to seize power in the area. They have become so violent that government officials are unable to appear in the region. It is estimated that there are at least one or two killings a day as a result of narcotics trafficking. Cocaine brings from \$700 million to \$1.2 billion every year to the Peruvian economy, while legal exports bring in \$2.5 billion.

**1.4.3.1.10 Colombia.** This country has become the cocaine industry processing and exporting center. Most of the raw materials come from remote areas of Peru and Bolivia. There are two areas where major drug traffickers have formed cartels. One is located in Medellin and the other in Cali. The Medellin cartel has gained more prominence than the Cali cartel; however, they have been known to work together in many aspects. These cartels have gained such wealth, influence, and power that they have considerable control over the affairs of Colombia in both political and economic matters. After the killing of a presidential candidate in Colombia, the Colombian government pronounced war against the Colombian drug cartels. As the war against the drug cartels escalated, the Colombian government began to make raids and seizures of cartel members' property. One piece of property, which was owned by Gonzalo Rodriguez Gacha, covered one city block. The mansion was almost entirely constructed of marble and had gold fixtures in the bathrooms with toilet paper that was designed with nude women on each sheet. Even lesser men of authority had equivalent estates. Gacha was finally cornered and shot to death. The other cartel members fled to the jungles. The cartel members still control much of the economy and exercise political power. Yet, one can read on an almost daily basis that the Colombian government is still actively involved in a war with the drug cartels. It is believed that the cartel attacked the Justice Building and killed many of the country's top judges. Many bombings are attributed to the cartels. In essence, this is a country under siege.

**1.4.3.1.11 Bahamas.** The Bahamas is an ideal way station between South and Central America and the U.S. It is estimated that over half of the cocaine shipments from South



America go through the Bahamas. Corruption in high office has surfaced for many years. One convicted drug trafficker testified in South Florida that he paid Prime Minister Lynden O. Pindling \$100,000 per week. Pindling has been the subject of many federal grand jury investigations and official inquiries in the Bahamas; however, he has never been charged in the U.S. and corruption proceedings in the Bahamas are rare. Bahamian police have been cooperative in the antidrug activities. Yet, many U.S. law enforcement officers confirm that the Bahamian police are being corrupted by drug traffickers. They take bribes from drug traffickers and at the same time inform on some of them.

**1.4.3.1.12 Cuba.** Castro prosecuted seven high-ranking officials for helping the Medellin cartel leader Pablo Escobar ship cocaine to Florida. Four of the conspirators were executed. This is the first time Castro acknowledged any official involvement in cocaine trafficking. In 1982, the U.S. Attorney in Miami indicted two members of the Central Committee of the Cuban Communist Party for marijuana trafficking. A former Panamanian official testified before Congress that Castro mediated a dispute between General Manuel Noriega and the Medellin cocaine cartel.

**1.4.3.1.13 Mideast.** The Middle East is a source of morphine base for the Sicilian and U.S. Mafias. Most of the morphine base comes from Turkey, Lebanon, and Pakistan. The impact on the local economies of these countries is limited so far. It does pump currency into their economy, but no reliable economic data are available. Other criminal activities in this area involve gun and weapon smuggling and sales, exploitation of foreign labor, smuggling of various consumer goods, and white slavery.

**1.4.3.1.14 Sicily.** Like Colombia, Sicily has become a country under siege by organized crime, the Sicilian La Cosa Nostra. The Sicilian Mafia had a governing commission, which was created by the American Mafia leader, "Lucky" Lucciano. But unlike their American counterparts, they began to fight among themselves. The Corlenesse family began to get the upper hand. One family head, Thomasa Buscetta, had to leave Sicily and flee to Brazil. The principal activity of the Sicilian Mafia was the control of the heroin trade. They imported morphine base from Turkey and other Mideastern countries. They processed the morphine base into heroin using French chemists. The heroin was smuggled to the U.S., where it was sold on the street. The profits were enormous. The money was smuggled back to Sicily and Switzerland through Bermuda. The Sicilian Mafia began to control Sicily. Judges and police were killed; in fact, anyone who tried to investigate their activities was killed. They had control of the economy. With the capture and trial of Buscetta, Sicilian authorities began taking back control; yet, today the Sicilian authorities are still battling the Mafia using military tactics against their heroin trafficking activities.

**1.4.3.1.15 Far East.** There are various criminal organizations in the Far East. In Japan, there is the Yakuza. In China, there are the Triads, with a long history expanding many centuries. In Indochina, there are various criminal organizations. One of the major producers of heroin is a place called the Golden Triangle, which encompasses an area around Laos, Cambodia, and Burma. All Asian criminal organizations are involved in drug production and trafficking, extortion, protection rackets, armed robberies, burglaries, gambling, prostitution, and slavery. Prostitution has grown to massive proportions in Thailand in recent years, with AIDS and other sexually transmitted diseases also on the rise. In

various parts of the countryside, these criminal groups control the local government or have become the local government as provincial lords.

## **1.5 Summary**

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The economic costs of crime affect both the individuals and the community. They also affect national governments. In some instances, governments are controlled or manipulated by criminal organizations. Some national economies are dependent upon illegal activities (i.e., drugs) in order to survive. One important factor to remember is that there is no victimless crime. Crime costs everyone either directly or indirectly.



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# Financial Crimes

# 2



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## 2.1 General

There are many types of financial crimes. Some of these crimes can be solved in a short period, while others will take a long time. The time required directly relates to the complexity of the crime. Complex financial crimes consume large amounts of time to gather huge amounts of financial records to support a conviction. However, all financial crimes have one common factor: greed. Most people are honest and trustworthy when the opportunity is not present. There are three factors that are present in financial crimes: (1) something of value must be present; (2) an opportunity to take something of value without being detected must be present; and (3) there must be a perpetrator who is willing to commit the offense.

The most common financial crimes are shown below. The federal statutes are shown for those crimes that are federal offenses. Many financial crimes are not directly an offense at the federal level, but they may indirectly become an offense. Some federal statutes place some state crimes under federal jurisdiction when the criminal crosses state lines.

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## 2.2 Arson

Arson is defined in law as the malicious and willful burning of another person's dwelling house or outhouse. The crime is not primarily concerned with the resulting property damage, but rather with the danger to which the occupants of the dwelling were exposed by the criminal act. *Dwelling* has a broad definition of encompassing any building. Setting fire to timberlands, prairies, or grasslands is a statutory offense. The burning must be willful or malicious to be arson. A person who burns a dwelling while committing a felony, such as burglary, is guilty of arson regardless of the absence of any intent to set the fire or to destroy the house. It is essential to the crime of arson that there be an actual burning of some part of the property. Mere scorching, smoking, or discoloration of the building without any charring, destruction, or actual burning is not sufficient to be a crime of arson. Arson is considered a felony in all states. Title 18 of the U.S. Code, Section 81 (hereafter 18 USC 81) prohibits arson of any federal installation, structure, or personal property.

## 2.3 Bankruptcy

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The prime characteristic of bankruptcy fraud is the hiding or nondisclosure of assets. This leaves little or no means of recovery by creditors. This is called “bust out.” Bust outs have become more prevalent in recent years, especially in high-inventory-turnover businesses. This crime usually requires identification of inventory purchased, sold, and “carted” off. Inventory is usually shipped to the enterprise premises. Afterwards, it is transported to another enterprise premises, which is controlled by the same principals. There it is sold, and the profits are diverted to the principals. Normally, a corporate shield will be in place to hide the principals involved in the scheme. Organized crime will take over a business not to keep it alive and healthy but to force the company into bankruptcy after making a quick cash profit. Individuals commit bankruptcy fraud by not disclosing or hiding assets from the trustee.

Bankruptcy is primarily a federal crime under 18 USC 151 through 157. It prohibits any debtor from concealing assets, making false oaths or claims, or bribery of any custodian, trustee, marshal, or other officer of the court charged with the control or custody of property (18 USC 152). It prohibits any person from knowingly or fraudulently appropriating any property for his or her own use, embezzling, spending, or transferring any property or secrets or destroying any document belonging to the estate of the debtor (18 USC 153). It is bankruptcy fraud if a person devises or schemes to defraud creditors (18 USC 157).

## 2.4 Bribery

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This is a crime of the offering and acceptance of money or favors for some kind of preferential treatment or to influence another party for such treatment whether in public service or private business. A problem in investigating bribery or kickbacks is the difficulty in tracing it back through books and records, if they exist at all. If the payment is uncovered, a problem arises as to locating who actually received the payment. To constitute this crime, the thing of value must be given with the intent of influencing official conduct. The acceptance of a gift without corrupt prior intent is not bribery. The offense of bribery includes the acts of both offering or giving and accepting or receiving, thereby rendering the giver as well as the receiver criminally liable. The offeror is guilty even if the bribe is refused. It is not required that the act for which the bribe was given be accomplished. 18 USC 201 prohibits anyone from directly or indirectly corruptly giving, offering, or promising anything of value to any public official or person with the intent to:

1. Influence any official act
2. Influence such public official to commit, aid in committing, or allow any fraud, or make opportunity for such commission on the U.S.
3. Induce such public official or person to do or omit to do any action in violation of lawful duty

## 2.5 Loan-Sharking

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Loan-sharking is the lending of money at higher rates than the law allows. Many people get involved with loan sharks. Gamblers borrow in order to pay gambling losses; narcotics

users borrow to purchase drugs; and businessmen borrow when legitimate credit channels are closed. Loan sharks menace both white- and blue-collar workers as well as small and large corporations. Employees have agreed to disclose corporate secrets, leave warehouses unlocked, steal securities, ship stolen goods, and pass along information about customers, which sets the business up for burglaries. Officers of both small and large corporations are forced to turn over control of their companies to organized crime.

Loan-sharking is identified as extortionate credit transactions under federal statutes, as well as many state statutes (18 USC 891 through 894). The elements of extortionate credit transactions are:

1. The extension of credit would be unenforceable through civil judicial processes against the debtor.
2. The extension of credit was made at a rate of interest in excess of 45% per annum.
3. The extension of credit was collected or attempted to be collected by extortionate means.
4. The interest or similar charges exceeded \$100.

Loan sharks' funds come from organized crime lieutenants that charge rates of 5 to 6% per week. The lieutenant has to pay from 1 to 3% per week. Sometimes the rates to the public reach 20% weekly. This is called a 6-for-5 loan, which means for every \$5 borrowed, \$6 is required to be paid weekly. The loan shark is usually more interested in getting interest than principal. When the borrower defaults on the loan, the loan shark resorts to force against the borrower or his family so that a borrower hesitates to report his dilemma to the authorities.

## **2.6 Credit Card Fraud**

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Credit card fraud is a multi-million-dollar business that hurts businesses and the public. Most credit card fraud is controlled by organized crime. The scheme is a classic pattern. Credit cards are stolen, fenced, and sent elsewhere. Generally, the credit cards are stolen before the credit card holder is able to report its disappearance, or before the issuing company is able to warn its subscribers of the theft so that they can refuse to honor them. Credit cards are often obtained in the following ways:

1. Credit card is stolen in the delivery process.
2. Credit cards are stolen in the printing process or duplicated.
3. Credit cards are stolen when returned to the issuer when they are refused or were undeliverable.
4. Credit cards are sometimes stolen on the street like cash or checks.
5. Business employees deliberately "forget" to return credit cards to their customers.
6. Credit cards are counterfeited.
7. Credit card numbers are copied from legitimate customers and used to make purchases.

A person who, with intent to defraud the issuer or a person or organization providing money, goods, services, or anything else of value, uses a credit card for the purpose of obtaining money, goods, services, or anything of value, without the consent of the cardholder, is committing credit card fraud. This is fraud by the customer. Credit card fraud is committed by businesses as well. Any person who uses a credit card to defraud an issuer or cardholder to acquire money, goods, services, or anything of value is committing credit card fraud. 15 USC 1644 as well as many state statutes prohibit the fraudulent use of credit cards. The federal statute prohibits:

1. The use of credit cards by any person who knowingly uses or conspires to use any counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtains credit cards to obtain money, goods, services, or anything of value aggregating \$1,000 or more
2. The transportation of or attempts or conspiracies to transport in interstate or foreign commerce any counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained credit card knowing it to be same
3. Anyone from knowingly receiving, concealing, using, or transporting money, goods, services, or anything of value from the fraudulent use of credit cards
4. Anyone from knowingly furnishing money, property, services, or anything of value through the use of fraudulent credit cards

The federal statute actually prohibits anyone from receiving, giving, or transporting goods, services, and other considerations through the use of fraudulent credit card use in addition to the fraudulent use of credit cards per 18 USC 1029.

## 2.7 Prostitution and Pandering

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Prostitution is the selling of oneself or another for purposes of sexual intercourse, debauchery, or other immoral act for monetary gain. A panderer is one who solicits clients for a prostitute, usually called a pimp. Their clients usually pay in cash, which is shared between the prostitute and the pimp. Organized crime is often involved. Credit cards have become acceptable. This is especially true in operations called escort services. Records are usually not maintained for very long. There are two types of prostitutes: street walkers and call girls. Street walkers get this name because they walk along the street drumming up clients. Call girls use referrals from friends, associates, and pimps. Many call girls rely on repeat clients. Many prostitutes are used to stealing from clients. Organized crime makes huge profits from prostitution.

Most states have statutes that prohibit prostitution and pandering. 18 USC 2421 prohibits anyone from transporting any individual in interstate or foreign commerce with the intent that such individual engage in prostitution or in any sexual activity. Section 2422 prohibits anyone from persuading, inducing, enticing, or coercing any individual to travel interstate to engage in prostitution or any sexual activity. Section 2423 prohibits the transportation of minors to travel interstate for prostitution or sexual activity. A minor is defined as anyone under 18 years of age.

## 2.8 Fencing

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This involves the purchase of stolen goods by someone from a thief. In general, this involves organized crime figures stealing large quantities of goods, usually from hijacked trucks, ships, or planes, and distributing and selling the merchandise.

1. **18 USC 2113(c)**. Prohibits anyone from receiving, possessing, concealing, storing, bartering, selling, or disposing of any property or money or anything of value that has been taken or stolen from a bank, credit union, or savings and loan association.
2. **18 USC 2114(b)**. Prohibits anyone from receiving, possessing, concealing, storing, bartering, selling, or disposing of any property or money or anything of value that has been taken or stolen from the U.S. Postal Service.

The federal statutes are limited to the fencing of personal property that is stolen from government control or financial institutions.

## 2.9 Mail-Order Operations

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These operations involve fraudulent schemes of advertising products in the media, such as magazines, newspapers, radio, internet or television. Customers send money to the mail-order house. The mail-order house keeps the money but does not ship the merchandise. This is called a “boiler room” operation. Sometimes, operators use high-pressure telephone solicitors who call and persuade, e.g., “You’ll miss out on this great deal if you don’t buy now” or “This deal is too good to pass up.” The most common characteristic in this kind of fraud is that you cannot reach them later because the telephone is disconnected or the address is no longer valid. There are three basic federal statutes that address this type of fraud:

1. **18 USC 2325**. Prohibits anyone from conducting a plan, program, promotion, or campaign to induce someone to purchase goods or services or participate in a contest or sweepstakes through the use of the telephone.
2. **18 USC 1341**. Prohibits anyone from scheming or defrauding anyone by obtaining property or any means of false or fraudulent pretenses, representations, or promises through the use of mail service by the postal service.
3. **18 USC 1343**. Prohibits anyone from scheming, defrauding, or obtaining money or property by means of false pretenses, representations, or promises through the use of wire, radio, or television communication in interstate or foreign commerce.

## 2.10 Pornography

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This industry includes the production, distribution, and sale of sex novels, magazines, photographs, stag films, and other sex-related items. Most of these items can be purchased in adult bookstores. Manuscripts are purchased from individuals for a minimal price and sent to a printing firm for large-volume printing. In the case of video or films, the master negatives or videos are purchased from a producer and put into mass production. The



books, videos, and films are sold to adult bookstores through shell corporations for legal insulation. Payments are not always paid to the printing and production firms once the books, videos, and films are delivered.

Organized crime usually does not directly own the retail adult bookstores. When they do own these stores, they hire employees to actually operate the stores for a salary. In some areas where adult bookstores are illegal, hard-core material is generally sold “under the counter” and only to those customers who are not suspected to be law enforcement officers.

Another attraction of adult bookstores is the peep show. This is a viewing machine where a customer can see a stag video or film. Each film or video is usually 12 minutes in length and the customer is required to drop a quarter for every 12-minute segment. 18 USC 2251 prohibits any person from employing, using, persuading, inducing, enticing, or coercing any minor to engage in or transport any minor in interstate with the intent to have such minor engage in sexually explicit conduct for the purpose of producing any visual depiction of such conduct. 18 USC 2258 prohibits the importation of child pornography.

## 2.11 Gambling

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Gambling attracts organized crime. Large gambling operations require a staff to run them. Organized crime in large cities controls gambling operators. Gambling involves betting on sports events, lotteries, off-track racing, large dice games, and illegal casinos. Most large gambling operations have a sophisticated organization that ranges from the operator who takes bets from customers through people who pick up money and betting slips, to people in charge of particular areas or districts, to the main office or bank. The profits move through channels so complex that even most people working for the organization do not know the identity of the leader. The uses of telephone systems have kept the bookmaker remote from the district or area management.

Independent bookmakers have joined organized crime operations for the following reasons:

1. Organized crime syndicates have resources for backing all bets, so the independent operator does not hedge his bets or reinsure bets through a “layoff” operation.
2. Independent operators can handle more bettors.
3. The bookmakers do not need to work on the streets taking bets.
4. The bookmakers no longer have to handle many telephone bets, which could alert police.
5. The bookmakers have legal services and connections available to them.
6. The bookmakers have territorial assignments, which minimizes conflicts with other bookies.

18 USC 1955 prohibits anyone from conducting, financing, managing, supervising, directing, or owning all or part of an illegal gambling business. The gambling activities must also be illegal under state law or any political subdivision and involve five or more people. It does not apply to gambling activities, i.e., bingo, lottery, or similar games of chance by an exempt organization as defined by the Internal Revenue Code, Section 501(c),

if no part of the gross receipts inures to the benefit of a private member or employee of the organization.

Bettors usually do not know the location of the betting operation, but the bookmaker advises the bettor of the telephone numbers at which bets can be placed. The bettor is later contacted by telephone for collection and payment. The bookie usually makes 10% before paying off winners, expenses, and commissions to runners and solicitors.

Projections of income should be based on gambling records seized by law enforcement on the number of days of operations shown in the records. Bookmakers do not keep records for any great length of time, usually about 1 or 2 weeks. Gains from this activity will usually require an indirect method of proving income.

## **2.12 Skimming/Embezzlement**

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Skimming is the act of diverting business receipts to one's own personal use. Officers or owners of the business enterprise can only do this. Embezzlement is diverting funds or receipts of the business by an employee. Cash businesses are very susceptible to both skimming and embezzlement, such as bars, nightclubs, grocery stores, laundromats, coin-operated machines, liquor stores, etc. In most cases, funds skimmed or embezzled usually cannot be traced from the business enterprise to the individuals. An indirect method of proving income is usually required. 18 USC 641 prohibits any person from embezzling, stealing, purloining, or knowingly converting to his use or the use of another, without proper authority, or selling, conveying, or disposing of any record, voucher, money, or anything of value that belongs to the U.S. or any department or agency thereof.

## **2.13 Labor Racketeering**

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Labor unions provide many methods for illicit gains:

1. Kickbacks from employers for favorable contracts and labor peace are common, as is extortion.
2. The unions can provide a vehicle for embezzlement. Organized crime syndicates use excessive or fictitious salaries or expenses, nonworking associates, or personal work done by union officers or employees. Professional or legal services are used to benefit union officials or employees. Sometimes they make donations to organizations for the benefit of a union official or employee.
3. Welfare and pension funds provide vehicles for kickbacks from insurance agents and organized crime investments and loans.

The audit program and techniques are many and varied when dealing with union racketeering.

There are various federal statutes that deal with the many facets of labor racketeering. They are:

1. **18 USC 1027.** Prohibits a pension plan administrator from making false statements or concealing facts or information relating to pension plans that are covered by the Employee Retirement Income Security Act of 1974 as amended.
2. **18 USC 664.** Prohibits any person from embezzling, stealing, or unlawfully or willfully abstracting or converting to his own use or the use of another any money, funds, securities, premiums, credit, property, or other assets of any employee welfare benefit plan or employee pension benefit plan.
3. **18 USC 1954.** Prohibits any administrator, officer, trustee, custodian, counsel, agent, or employee from offering, accepting, or soliciting any fee, kickback, commission, gift, loan, money, or anything of value with the intent to influence any action or decision with respect to employee pension or benefit plans. Also, it is unlawful for anyone to offer, solicit, kickback, or give any commission, gift, loan, money, or anything of value to influence the action or decision of a plan administrator, trustee, etc.

## 2.14 Stock Fraud and Manipulation

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Some criminals use stock and bond fraud schemes to make illicit gains. They use counterfeit stock certificates as collateral on loans. They set up dummy corporations to sell worthless stock in boiler room operations. A legitimate corporation can be taken over and sold back and forth between insiders so as to highly inflate the market price of the stock. After the stock is sold at highly inflated prices, the company would be abandoned and the stock allowed to drop to the correct market value. Stock and bond fraud is a complex and sophisticated area. Extremely detailed investigation and analysis are required. The investigation requires analysis of transactions before, during, and after the scheme to determine the trends.

The federal statutes that deal with securities fraud are:

1. **18 USC 513.** Prohibits anyone from making, uttering, or possessing counterfeit securities of any state, political subdivision, or organization.
2. **18 USC 2314.** Prohibits the transporting, transmitting, or transfer of securities when anyone knows that the securities have been stolen, converted, or taken by fraud.

## 2.15 Narcotics

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The sale of narcotics is organized like a well-organized large corporation. It involves numerous people from all levels. The large amount of profits and the international connections necessary for long-term narcotic supplies can only be supplied by a criminal organization. There are various types of narcotics, which come from various parts of the world. Heroin comes from Turkey in the Middle East and the Golden Triangle in Southeast Asia. Cocaine comes from Central and South America. Synthetic drugs are made in the U.S. and Canada. Organizations involved in distribution are loosely knit for the most part, and involve individuals of all walks of life. The profits from narcotics are enormous. Federal

statutes that address drug trafficking are listed under Title 21 of the USC. The principal sections are:

- 848. Defines continuing criminal enterprise as any person who occupies a position of organizer, supervisor, or any management position with five or more other people who engage in illegal drug manufacturing, distribution, and sale, and obtains substantial income or resources.
- 858. Prohibits anyone from manufacturing or transporting any material, including chemicals that create a substantial risk to human life.
- 860. Prohibits the manufacturing and sale of controlled substances in or near schools and colleges within 1,000 feet.
- 952. Prohibits the importation of controlled substances.

## 2.16 Racketeering

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In the past, racketeering was hard to define. In 1968, when the Omnibus Control and Safe Street Act was passed, racketeering was defined as any unlawful activity by members of a highly organized, disciplined association engaged in supplying illegal goods and services. In 1970, Congress passed the Racketeer Influenced and Corrupt Organization (RICO) statute, which has become the centerpiece of federal and most state law proscribing organized criminal activity. A pattern of racketeering activity requires at least two acts of racketeering activity. Racketeering activity means almost any illegal act, such as gambling, murder, kidnapping, robbery, drug trafficking, etc. It encompasses any individual, organization, corporation, or union or group of associated individuals. RICO was not used very much until the late 1970s and early 1980s when many organized crime figures were indicted and convicted of racketeering. When the conviction rates soared, district and U.S. attorneys became more aggressive. Now, RICO indictments are becoming more common. However, convictions are not increasing as much as the indictments. The major reason is the lack of evidence, particularly in the form of financial data. The RICO Act provides for the use of financial data in prosecutions and forfeitures. Section 1963 of Title 18 reads as follows:

In lieu of a fine otherwise authorized by this section, a defendant who derives profits or other proceeds from an offense may be fined not more than twice the gross profits or other proceeds.

(b) Property subject to criminal forfeiture under this section includes:

- (1) Real property including things growing on, affixed to, and found in land; and
- (2) Tangible and intangible personal property, including rights, privileges, interests, claims, and securities.

Clearly financial data is a major element in these criminal cases. In some instances, the gross profits are more than the net assets of the criminal or criminal enterprise. In other cases, the fines or penalties are less than the gross profits of the illegal enterprise.

This will put any criminal enterprise out of business if there is a conviction, since forfeitures are based on gross profits instead of fines and penalties.

## **2.17 Continuing Criminal Enterprise**

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This is defined by 21 USC 848. Many states have adopted variations of this statute as well. It defines continuing criminal enterprise as any person who commits three or more felonies with five or more other persons with respect to whom such person occupies a position of organizer, a supervisory position, or any other position of management, and who obtains substantial assets or resources from these acts. The elements of this offense are:

1. A person has committed three or more felonies.
2. The person is in a supervisory capacity.
3. The person has five or more people working for him in some illegal capacity.
4. The person has acquired substantial assets or financial resources.

21 USC 855 repeats the fines as stated in 18 USC 1963; that is, “In lieu of a fine otherwise authorized by this section, a defendant who derives profits or other proceeds from an offense may be fined not more than twice the gross profits or other proceeds.”

## **2.18 Nonprofit Organization Fraud**

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This type of fraud is primarily a tax fraud even though other types of fraud are also committed. In some cases, the victims do not know that they have been defrauded, while in other cases, the victims suffer both great financial and emotional losses. The Internal Revenue Service, as well as many state laws, allow various types of organizations to operate without paying taxes, obtaining permits and licenses, and exempt them from various laws and regulations. Religious institutions, social clubs, paternal organizations, and various charities operate to help or benefit their members or the community in which they operate. These nonprofit organizations are very beneficial to members and the community; however, there are individuals who operate or control these organizations for their own benefit, and this is illegal. As a case in point, bingo operations are legal in most states when they benefit the nonprofit organizations that sponsor them. However, some bingo operations are conducted for the sole benefit of operators, which is illegal. Social clubs operate bars and restaurants for the benefit of their club members. However, some social clubs operate for profit, which benefits the operators. After the terrorist attack on September 11, 2001, it was discovered that certain nonprofit organizations have financed terrorist activities. The Patriot Act was passed in October 2001. It made financing terrorist organizations illegal.

### **2.18.1 Corrupt Churches**

Churches and other religious organizations are exempt from federal and state taxes. These organizations do not pay property, sales, or income taxes. However, there are individuals and criminal organizations that like using a church cover to obtain profits and gains for their own benefit. There are three facets of an abusive church. First, the church appears to be an attractive group of motivated, high-principled Christians or other religious sect.

They want to talk to you. They want you to be part of their church. The rank and file of its membership sees the second facet: discipline and authority. The word of the leader is law. No questioning is allowed. The leader is always demanding more from you — more commitment to the church or group, more obedience to the leader's directives, more financial sacrifices, more separation from friends and family, more adulation of the leader. Its inner core of leadership sees the third facet: excess. The leader, his immediate family, and his inner, favored group lead a life of open or secret extravagance. The signs of a corrupt church are:

1. The church is God's special, and perhaps only, true church on earth at this time. You may be called upon to make great sacrifices now, but they will be worth it, because not to join the church is to miss out on your chance to be in God's grace or favor.
2. The human leader is the link to God. He is the most important person on earth. His interpretation of the Bible or similar religious literature is the only correct one. The leader never wants any criticism. He denounces any criticism as the product of a negative attitude.
3. The leadership attempts to control your personal life. The leader sets forth his own rules and regulations. You are told what to eat and wear, how to live and raise your children, who or whether to marry or divorce, etc.
4. The member is no longer responsible for himself or herself. The leader tells the member what is right and wrong. The member has no mind or conscience of his own. The member becomes confused by contradictory attitudes and strives to subjugate himself to the church.
5. The church is the only reality. True spirituality and obedience to God are found only in this church. The rest of society is Satan's world of vanity and deceit. The member will find himself less able to function "in the world," but more at home "in the church." The member will move to church headquarters, live in church accommodations, work for a church-owned business, spend spare time in church activities, and be friends with only church members. The member's life is totally consumed by the church.
6. The church is isolated. It only wants to build and maintain membership, improving its image in society and gratifying the whims of the leadership. The church wants to keep its financial affairs secret. It does all it can to avoid newspaper reporters so that they will not publish "gross lies and distortions."
7. The church is a prison. Once in the church, the member is a captive. If the member leaves the church, he leaves behind his financial security, home, job, and family.

This type of crime usually comes under the federal civil rights laws, which are listed in 18 USC 241 through 248.

## **2.19 Burglary**

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Burglary is defined as the breaking and entering of a dwelling place or habitation of another with the intent to commit a felony therein. The statutory offense of burglary includes trains, automobiles, barns, business establishments, storehouses, public buildings,

telephone coin boxes, and boats. It is the intent of the perpetrator in the breaking and entering to commit a felony. Without such intent, the mere breaking and entering may only be a civil trespass and not punishable as a crime. Breaking does not necessarily require physical damage to or any destruction of property. It is the breaking of the secureness rather than any physical violence to the property itself. It is breaking when an intruder unlocks a door, opens a window, or removes a screen or windowpane. If a person has permission to enter a building and then commits a felony inside, he has not committed burglary, because there was no breaking in order to make entry. Constructive breaking is made when an entry has been obtained by trickery, fraud, threats, intimidation, or conspiracy. If entry is achieved as the result of a pretense of a business or social call, it may be deemed to be breaking for purposes of committing burglary. Burglary requires entry into the dwelling as well as breaking. Burglars steal property for the purpose of selling the property to unsuspecting customers. Pawnshops are an ideal place to sell stolen property. However, the burglar cannot sell too much stolen property without the pawnshop owner becoming suspicious. Organized crime groups set up businesses for the purpose of selling stolen property. There are various federal statutes that involve burglary. These burglary statutes basically involve property either belonging to the U.S. or in possession of the U.S. The more common federal statutes are:

1. **18 USC 2112.** Prohibits anyone to rob or attempt to rob personal property belonging to the U.S.
2. **18 USC 2113.** Prohibits anyone from robbing banks and other financial institutions.
3. **18 USC 2114.** Prohibits anyone from robbing any postal service employee.
4. **18 USC 2115.** Prohibits anyone from robbing any postal facility.
5. **18 USC 2116.** Prohibits anyone from robbing any car, steamboat, or vessel assigned to carry mail service.

## 2.20 Forgery and Uttering

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Forgery is the false making or material alteration, with the intent to defraud, of any writing to the prejudice of another person's rights. The intent to defraud is the very essence of the crime of forgery. It is immaterial that the alteration or false writing in fact deceived no one. It is not necessary to show that any particular person was intended to be defrauded. A general intent to defraud is sufficient, and it is not limited to the possibility of obtaining money or other property. Forgery may be committed by writing in ink or pencil, by typewriter, printing, engraving, or even pasting one name over another. It has been frequently held that every such crime must contain at least the following two elements:

1. The signature was not made by the hand of the person whose signature it purports to be.
2. Another wrongfully made the signature.

It is not necessary that the entire instrument be fictitious, nor is it required that the forged document contain incorrect statements. The act of making a forged instrument in

its entirety is distinct from the act of altering an instrument already made, although both acts are forgeries. A forgery can be committed even though the name alleged to be forged is in fact a fictitious one. Signing a fictitious name to a check with the intent to defraud is forgery even where the check is made payable to cash. It is not necessary that the forged signature resemble the genuine one. Forgery may be committed by a person signing his own name where it appears that his name is the same as that of another person and he intends his writing to be received as that of such other person. Generally, a mere immaterial change or alteration that does not affect the legal liability of the parties concerned with the instrument involved does not constitute a forgery.

Uttering is the offering of a forged instrument, knowing it to be such, with the intent to defraud. It is immaterial whether such offer is accepted or rejected. A defendant may be guilty of uttering a forged instrument even though he was not the actual forger. The offense is committed when one knowing it is forged, with the representation by word or action that it is genuine, offers a false instrument. In this sense, the words *utter* and *publish* have frequently been held to be synonymous as used in forgery statutes. Specific instances of uttering or publishing have been held to include:

1. Exhibiting a forged license to present as evidence of a right to receive compensation
2. Depositing a forged check to one's own account
3. Delivering a forged note to satisfy a debt
4. Procuring the probate of a forged will
5. Using a forged instrument in judicial proceedings

The federal statutes that deal with forgery and uttering are:

1. **18 USC 472.** Prohibits uttering counterfeit obligations or securities of the U.S.
2. **18 USC 496.** Prohibits any forgeries, counterfeits, or false alteration of any writing made or required to be made in connection with the entry or withdrawal of imports or collection of Customs duties.
3. **18 USC 473.** Prohibits anyone from dealing in counterfeit obligations of the U.S.
4. **18 USC 482.** Prohibits any forgeries, counterfeits, or false alterations of any obligations or securities of foreign banks or corporations.
5. **18 USC 478.** Prohibits any forgeries or counterfeits of any bond, certificate, obligation, or other security of any foreign government.
6. **18 USC 1542.** Prohibits anyone from falsely making, forging, counterfeiting, mutilating, or altering any passport.
7. **18 USC 1546.** Prohibits anyone from forging, counterfeiting, altering, or falsely making any immigrant or nonimmigrant visa, permit, border-crossing card, alien registration receipt card, or other documents.
8. **18 USC 2314.** Prohibits anyone who transports in interstate or foreign commerce from falsely making, forging, altering, or counterfeiting securities, tax stamps, traveler's checks, or tools to be used in making, forging, or counterfeiting any securities.



## 2.21 Larceny

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The crime of larceny is the wrongful taking and carrying away of personal property of another person without his consent and with the intent to deprive the owner thereof of such property permanently. Many states divide larceny into two grades: grand larceny and petit larceny. The distinction between the two is usually based solely on the value of the appropriated property. In some states, the crime of larceny is known as theft and stealing.

There is no separate offense for each article taken at the same time. Similarly, stealing property at the same time and from the same place belonging to different owners constitutes only one offense of larceny since there is but one act of taking. Where separate items of property are stolen from different owners at different times, of course, separate larcenies have taken place. In order to be a proper subject of larceny, the thing taken by a defendant must conform to the following conditions:

1. It must be capable of individual ownership.
2. It must be personal rather than real property.
3. It must be of some intrinsic value, although it is not necessary that it have any special, appreciable, or market value.
4. It must have corporeal existence, regardless of its value to the owner who has had it. If it is not capable of a physical taking, then it is not a subject of larceny.

*Animus furandi*, the intent to deprive the owner permanently of the property taken, is an essential element of larceny. In order to indicate such intent, it has generally been held that the item of personal property must be taken from the possession of the owner or possessor into the possession of the thief and be carried away by him. There is no larceny when a person takes property temporarily with the intent of returning it later to the owner. The intent must be to deprive the owner permanently of his property. In order to constitute robbery as distinguished from larceny, either force or fear must be used by the thief. There is a distinction between owning something and having it in one's possession. Ownership is legal title; possession is physical control. Ownership and possession are regarded as synonymous in the crime of larceny. A taking in jest or mischief is not deemed to be larceny, particularly when such taking is done openly in the presence of numerous witnesses. The federal statutes that deal with embezzlement and theft are listed in 18 USC 641 through 668.

## 2.22 Robbery

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Robbery is the unlawful taking of any property from the person or in the presence of another by the use of force or intimidation. The offenses of assault and larceny are deemed to be essential elements of the crime of robbery. Robbery is a felony. The elements of this crime include:

1. A felonious taking
2. The use of actual or constructive force
3. No consent by the victim
4. Personal property of any value
5. An intent by the perpetrator to deprive the owner permanently of his property

A person is not guilty of robbery if forcibly taking his own property from the possession of another. It is not necessary to the crime of robbery that the property is taken from the actual owner. A robbery may be committed by a taking from the person having only care, custody, control, management, or possession of the personal property. It is vital to the crime of robbery that the taking of the property be accomplished by the use of force, fear, or intimidation. The degree of force or violence is immaterial if it is enough to compel a person to give up his property against his will.

The federal statutes that address robbery are:

1. **18 USC 1951.** Interference with commerce by threats or violence.
2. **18 USC 2113.** Robbery of banks and other financial institutions.
3. **18 USC 2119.** Robbery of motor vehicles with the intent to cause death or serious bodily harm in interstate or foreign commerce.

## 2.23 Tax Evasion

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The federal and state governments have laws that make it a felony for those who willfully attempt to evade or defeat any tax. The crime of willful tax evasion is completed when the false or fraudulent return is willfully and knowingly filed. Tax evasion must be proved by an affirmative act. The willful failure to collect or pay tax is a felony. Likewise, it must be proved by an affirmative act. The net worth, nondeductible expenditure method (explained in Chapter 5) is the one most used by the Internal Revenue Service and states with individual income tax laws. These methods have been approved by the Supreme Court. Voluntary disclosures by taxpayers of intentional violation of tax laws prior to the initiation of an investigation do not ensure that the government will not recommend criminal prosecution. There is no requirement that returns be made under oath. The law merely requires that returns contain a declaration that they are made under the penalties of perjury. Perjury is considered a felony. Any person who willfully delivers or discloses any list, return, account, statement, or other document that is known to be fraudulent or false is committing a crime. The federal government classifies this as a misdemeanor; however, many states classify this as a felony. The taxpayer is responsible for the correctness of any return filed, even if he pays a preparer. If the preparer has willfully prepared a false return, then he or she can be criminally prosecuted.

26 USC 7201 through 7216 deal with the various types of criminal tax law violations.

## 2.24 Bank Frauds

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Bank frauds encompass both customers and employees of banks. Bank frauds relate to the passing of bad checks, fraudulent loans, and check kiting. Officers or employees usually embezzle funds from the bank through various schemes. Customers defraud banks by writing bad checks or presenting false documents to obtain funds. 18 USC 1344 defines bank fraud as anyone who knowingly executes or attempts to execute a scheme to defraud a financial institution. It involves obtaining any of the money, funds, credits, assets, securities, or other property owned by, or under the custody or control

of, a financial institution by means of false or fraudulent pretenses, representations, or promises. The financial institution does not have to suffer a loss. A person only has to submit false documents.

## **2.25 Restraint of Trade**

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Restraint of trade is a violation by corporate decision makers on behalf of their organizations. The major federal statute involved is the Sherman Antitrust Act of 1890. It was designed to curb the threat to a competitive, free enterprise economy posed by the spread of trusts and monopolies to combine or form monopolies. There are three principal methods of restraint of trade:

1. Consolidation, so as to obtain a monopoly position
2. Price fixing to achieve price uniformity
3. Price discrimination, in which higher prices are charged to some customers and lower ones to others

For those corporate decision makers, restraint of trade makes sense in that the less competition a corporation has and the greater control over prices, the larger the profits. However, small and independent businesses will lose business and the public at large will face higher prices and loss of discretionary buying power. The most common violations are price fixing and price discrimination.

## **2.26 Government Contract Fraud**

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There are many federal statutes that involve fraud against the government for products and services. They can be classified into the following categories:

1. Fraudulent billing for products and services
2. Providing faulty or inferior products or services
3. Providing substituted products
4. Overcharging on government contracts

## **2.27 Corporate Raiding**

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Corporate raiding involves individuals or organizations that take over business entities for the purpose of exploiting the business assets for gain. These corporate raids may be for the control of the industry or for personal gain. Generally, corporate raiding involves either violations of the Sherman Antitrust Act or a combination of other offenses, e.g., embezzlement, pension fraud, bankruptcy fraud, or stock fraud or manipulation.

## 2.28 Extortion

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This crime involves the threat by an individual to another for money. It is usually committed by criminal organizations in the areas where they operate, but they do not have control of the market on this type of crime. Many of the federal statutes address extortion. 18 USC 871 through 880 address extortion by or to federal employees.

## 2.29 Coupon Fraud

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This crime usually involves individuals who operate a business. The business operator collects various coupons and submits them to either a clearinghouse or to the company that issued them for refunds or rebates on products that bogus customers have purchased from the business. This is primarily a state crime, but the federal statutes for mail fraud would normally apply in this type of case.

## 2.30 Money Laundering

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Money laundering is a criminal offense under 18 USC 1956, 1957, and 1960. It is a crime for individuals or business entities to launder gains from illegal activities through various methods and schemes. Money laundering activities encompass:

1. Transporting money and other money instruments to and from offshore
2. Purchasing various intangible and tangible properties with large sums of cash
3. Depositing large sums of cash into various financial institutions
4. Maintaining bank accounts offshore with large balances
5. Transmitting funds on behalf of the public, whether offshore or within the country
6. Any funds derived from illegal activities

Title 31, Money and Finance, Sections 5311 through 5355, goes into money laundering and reporting by various financial institutions and businesses. Financial institutions are very broadly defined; they include but are not limited to banks, credit unions, brokers, the postal service, pawnbrokers, travel agencies, dealers in precious metals, stones, or jewels, casinos, etc. There are penalties for not properly reporting cash or cash equivalent transactions by almost anyone. Chapter 19 describes these reporting requirements, forms, and penalties and will provide money laundering investigative techniques.

## 2.31 Medicare and Medicaid Fraud

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This crime involves various health care providers submitting claims to the government programs for services and products that were not provided or overcharging for those services and products. 18 USC 286 makes any conspiracy or claim against the government a crime. It states, "Whoever enters into any agreement, combination, or conspiracy to defraud the United States, or any department or agency thereof, by obtaining or aiding to obtain the payment or allowance of any false, fictitious or fraudulent claim, shall be fined under this title or imprisoned not more than ten years, or both."

### 2.32 Repair and Maintenance Fraud

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Maintenance and repair attracts swindlers who prey on consumers because typical consumers find it necessary to maintain or repair things that they own but do not usually have the time, resources, or know-how to do for themselves. The best opportunities for fraud in maintenance and repair are expensive products and those so sophisticated or specialized as to be beyond the technical expertise of most consumers. Automobiles, electrical appliances of every sort, and home maintenance items are the most susceptible. Home maintenance is especially common. 18 USC 286 is used to prosecute those elements that submit false, factitious, or fraudulent claims to the U.S.

### 2.33 Computer Thefts

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Computer crime is viewed more as a means of crime than a type of crime. As an instrument of crime, the computer may be used to victimize individuals, one's own company, competitive companies, the government, the public at large, or even other countries. Computers are involved in the following ways:

1. To submit false claims to employers or government agencies
2. To embezzle funds from one's employer or financial institutions
3. To manipulate stock and bond prices
4. To delete information that may be harmful if made known
5. To delete information that would interrupt business day-to-day activities
6. To sell company secrets or software

18 USC 1030 deals with computer fraud and related activities. It prohibits:

1. Accessing government computers without authorization that require protection against unauthorized disclosure
2. Intentionally accessing financial institution or card issuer records without authorization
3. Accessing government computers of any department or agency without authorization
4. Accessing a government computer to defraud the government
5. Transmission of a program, information, code, or command to cause damage to a computer system, network, information, data, or program used in interstate commerce or communications

### 2.34 Insider Trading

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It is a crime under federal and state statutes for corporate officers or employees of companies to trade their stocks or bonds on the various exchanges when they have knowledge of their company's internal activities. The Securities Exchange Act of 1933 as amended prohibits this kind of conduct. Indictments for insider trading are usually returned under both 18 USC 1341 and 15 USC 77(x).

### 2.35 Corporate Fraud

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Corporate fraud involves crimes committed by organizations or to organizations in the following areas:

1. Stealing company secrets by employees for gain
2. Stealing company secrets by corporate organizations, often called corporate espionage
3. Copyright and patent infringements
4. The production, distribution, and sale of harmful food and drug products to the public

It is not a federal crime for an employee or organization to steal secrets from a business organization unless the theft deals with interstate or foreign commerce (18 USC 2315).

Copyright fraud is a violation under 18 USC 2319. The production, distribution, and sale of harmful food and drug products to the public are governed by various sections of Title 21 of the USC. In 1906, Congress passed the Federal Food and Drug Act, which was the first step in declaring it illegal to manufacture or introduce into the market any adulterated or misbranded food or drug. Congress further expanded this in 1938, when it passed the Food, Drug, and Cosmetic Act. This expanded the former act to cover areas of cosmetics and other health devices.

### 2.36 Swindlers

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Swindlers are con artists who rely on the principle of getting something for nothing. They do this through a system of persuasion. First, they must find a victim. Second, they gain the confidence of the victim. Third, they convince the victim to depart with something, usually money, on some enterprise. And fourth, they get rid of the victim through consolation and not by fear. There are many hundreds of variations. It may take con artists only a short period to fleece a victim, or it may take a long time. 18 USC 1341 prohibits swindlers from using the postal service to defraud or obtain money by means of false or fraudulent pretenses, representations, or promises. 18 USC 1343 prohibits swindlers from using wire, radio, or television to defraud or obtain money by means of false or fraudulent pretenses, representations, or promises.

### 2.37 Conspiracy

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A person who agrees, combines, confederates, or conspires with another person to commit any criminal offense is committing a felony. Usually, the punishment for conspiracy is related to the type of crime that the person is conspiring to commit. The person does not have to commit the offense, but only agree or plan to commit the offense. The offense does not have to take place. The most commonly used federal conspiracy charges revolve around 18 USC 241, 1951, and 1962.

### 2.38 Principal

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A principal is anyone who commits or attempts to commit any criminal offense or aids, abets, counsels, hires, or otherwise procures such offense to be committed. The person does not actually or constructively have to be present at the time of the commission of such offense (18 USC 2).

### 2.39 Accessory

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A person can be an accessory either before or after the fact. An accessory is anyone who gives an offender any aid, knowing that he had committed a felony. Normally, an accessory after the fact aids the criminal with the intent to escape detection, arrest, or trial. The primary element is that the accessory has knowledge that a person committed an offense (18 USC 3).

### 2.40 Kidnapping

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Kidnapping means forcibly, secretly, or by threat confining, abducting, or imprisoning another person against his will and without lawful authority, with the intent to:

1. Hold for ransom or reward or as a shield or hostage
2. Commit or facilitate commission of any felony
3. Inflict bodily harm upon or to terrorize the victim or another person
4. Interfere with the performance of any governmental or political function

Under 18 USC 1201 through 1204, kidnapping is a capital offense.

### 2.41 Theft

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Theft is normally defined as any person who obtains or uses, or endeavors to obtain or to use, the property of another with intent to either temporarily or permanently deprive the owner. Many states have placed various degrees of theft, from petit to grand theft, which are usually based on the value of the property taken. In addition, many states address particular types of theft. The most common are shoplifting, hijacking, trade secrets, utilities and cable theft, dealing in stolen property, mortgage or loan fraud, cheating, and misleading advertising. (See the paragraphs on larceny, burglary, and robbery.) 18 USC 2311 through 2322 address theft of various kinds of property that crosses state lines.

### 2.42 Identity Theft

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Identity theft or fraud is any type of crime where someone wrongfully obtains and uses another person's personal data in some way that involves fraud or deception. Typically, it is for economic gain. Personal data, especially Social Security, bank account, credit card, and telephone calling card numbers and other valuable identifying data, can be used to

profit at the victim's expense. With enough identifying information about an individual, a criminal can take over an individual's identity to conduct a wide range of crimes. This would include false applications for loans and credit cards, fraudulent withdrawals from bank accounts, and obtaining other goods and services that the criminal would probably be denied if he used his real name. 18 USC 1028 makes it a crime to fraudulently obtain, possess, or use someone's identity.

### **2.43 Child Support**

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Many states have laws that make it a crime for a person to misuse child support payments, whether from another person or by any government agency. A person shall be deemed to have misapplied child support funds when such funds are spent for any purpose other than necessary and proper home, food, clothing, and the necessities of life, which expenditure results in depriving the child of the above-named necessities. Some states require public welfare agencies to give notice of these provisions at least once to each payee of any public grant for the benefit of any child and shall report violations to the proper authorities.

The failure to pay legal child support obligations with respect to a child who resides in another state is a violation under 18 USC 228.

### **2.44 Counterfeiting**

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Counterfeiting is the act of imitating something genuine so as to defraud someone. Most people think of counterfeiting in terms of printing money or forging coins that are false. However, both federal and state statutes provide for criminal sanctions for imitating, publishing, or tendering anything with the intent to utter and pass something as true. Counterfeiting can encompass money, contracts, merchandise, documents, licenses, certificates, or any document or property. 18 USC 470 through 513 deal with many kinds of counterfeiting under federal statutes. Also, 18 USC 2320 prohibits trafficking in counterfeit goods or services.

### **2.45 Bad Checks**

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Most states have statutes that prohibit anyone from giving checks, drafts, bills of exchange, debit card orders, or other orders on banks without first providing funds in or credit with the depositories on which the same are made or drawn to pay and satisfy the same. It usually includes any person who, by act or scheme, cashes or deposits any item in any bank or depository with intent to defraud. Bad checks, drafts, etc., are prohibited for purchasing goods and services with the intent to defraud any person, firm, or corporation.

The issuing of bad checks comes under the bank fraud statute, 18 USC 1344.

### **2.46 False Statements**

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18 USC 1001, as well as many state statutes, prohibits anyone from giving false information to any law enforcement officer or official in the performance of his or her duties. 18 USC 1001 reads:



Whoever, in any manner within the jurisdiction of any department or agency of the United States and knowingly and willfully falsifies, conceals or covers up by any trick, scheme, or device a material fact, or makes false, fictitious, or fraudulent statements or representations, or makes or uses any false writing or document knowing the same to contain any false, fictitious or fraudulent statement or entry, shall be fined under this title or imprisoned not more than five years, or both.

## **2.47 Misprison of Felony**

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18 USC 4 defines a misprison of felony as:

Whoever, having knowledge of the actual commission of a felony cognizable by a court of the United States, conceals and does not as soon as possible make known the same to some judge or other person in civil or military authority under the United States, shall be fined under this title or imprisoned not more than three years, or both.

The key element in this offense is that one, having knowledge of an offense, must take an affirmative act in reporting the crime.

## **2.48 Summary**

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There are many federal statutes that cover a wide variety of crimes, most of which are financially related. States and possessions of the U.S. have the same or similar laws. A fraud examiner must know the state or federal statute that is being violated in order to examine and gather evidence to support a conviction. The fraud examiner should study the appropriate statute and determine the elements of each offense, and then he should see if the evidence supports each one of the elements required to sustain a conviction.



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## 3.1 General

Criminal organizations, as well as individuals, have taken their illegal gains to offshore countries. Legitimate businesses have been using offshore countries for many years to avoid taxes and preserve capital. These countries that offer various business services, especially to multinational corporations, are called tax havens. International businessmen know that countries have different tax systems. These disparities may constitute tax havens in relation to a particular operation or situation, compared with the tax treatment given to the identical taxable event in another country's tax system. Hence, *tax haven* is a relative concept. As mentioned in Chapter 12, organized crime and individual illegal operations pay no taxes on their income; therefore, tax havens are very attractive vehicles for hiding their untaxed income from both tax authorities and law enforcement. Secrecy is an important element for criminals.

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## 3.2 Characteristics

Tax havens have many common characteristics, which make them ideal for both multinational businesses and criminal organizations. These characteristics are described in the following subsections.

### 3.2.1 Taxes

Countries fall into one of five categories when it comes to tax systems:

1. Countries that impose virtually no direct taxes
2. Countries that impose tax at relatively low rates
3. Countries that impose tax only on domestic source income
4. Countries whose tax treaties can be used as a conduit
5. Countries granting special tax privileges

Organized crime and white-collar criminals, of course, prefer categories 1 and 2. The primary function is to eliminate the connecting factor between the taxing jurisdiction and

the taxpayer or taxable event. The principal connecting factors for individuals are residence, domicile, and citizenship. For companies, the connecting factors are management and control, ownership, place of incorporation, and location of registered office. An important connecting factor is the center of economic interests and the presence of a permanent establishment. Therefore, organized crime and criminals try to eliminate any connecting factors between the taxable events — profits from narcotics trafficking, gambling, loan-sharking, etc. — and the taxpayers, i.e., the crime figures at all levels.

### **3.2.2 Exchange Control**

The exchange control system of a country is a body of statutory and administrative regulations that has an objective of control over a country's liquid resources abroad and the international movement of currency owned by its residents. Both organized crime and multinational companies seek countries that have little or no exchange controls. This affords them the ability to easily and quickly transfer funds without any interference.

### **3.2.3 Banking**

Much international banking takes place offshore. Most of the world's banks have operations in tax havens. Tax haven countries have enacted various laws and set up regulatory agencies to control banking activities. Banks offer the same type of services in tax havens as they do in other countries; however, branch offices of international banks in tax havens have the ability to move funds swiftly and have better expertise in handling international transactions. Nonresident banks are only licensed to serve clients who are not tax haven residents.

### **3.2.4 Bank Secrecy**

Secrecy is an important element in tax havens. The banker is required to keep the customer's affairs secret. In some tax havens, breaches of bank secrecy are a criminal violation; however, there are specific exemptions where the banker is discharged. Organized crime cherishes tax havens with bank secrecy laws. This gives them the ability to further hide the illegal gains.

### **3.2.5 Stability**

Political and economic stability is an important factor. Neither businessmen nor criminal organizations want to do business with any country that is not politically and economically stable.

### **3.2.6 Communications**

Communications is another factor in selecting a tax haven. Some tax havens are small islands that have limited communication and transportation facilities. The Colombian cartels have used small islands as transshipment points. These transshipment points require good communications. The Colombian drug cartels have installed sophisticated communication equipment and facilities on small islands in the Caribbean. Organized crime requires good communication facilities so that illegal gains can be transferred by wire quickly and easily.

### 3.2.7 Corruption

International businessmen do not want to establish operations in a tax haven country in which public officials are corrupt. This would require them to make payoffs and kickbacks to public officials, which in turn reduces their profits. On the other hand, organized crime has the opposite view. Its members want to make payoffs and kickbacks so the public officials will look the other way and will not interfere with their operations. For organized crime, this is a small price of doing business.

## 3.3 Tax Haven Countries

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The following countries are classified as tax havens because they seek business and promote themselves as tax havens. In addition, criminals and organized crime elements look to these countries for ways of money laundering and concealing their illegal gains.

### 3.3.1 Andorra

This principality is located in the heart of the Eastern Pyrenees, between France and Spain. It is a principality covering 468 square kilometers in mountainous terrain. It lacks adequate transportation, since there is no airline and train service. Roads can be clogged for up to 3 hours. It has a president, who is elected by the General Counsel or Parliament. The Parliament members, called *consellers general*, are elected. There are no taxes on income, capital, and duties, although the country does have a property tax imposed by the local *Comu* (a parish) each year. The official language is Catalan, but French and Castilian are in daily use. English is understood in banks and public offices. Both the French franc and the Spanish peseta are everyday currencies. There are no exchange controls or monetary authority. The telephone system is tied to both the Spanish and French systems, so it is possible to dial out through either country. Generally, the service is efficient and costs are similar to those of neighboring countries. The postal system is supplied by the French and Spanish postal services, which provide their own stamps. They generally follow Roman law; however, in many instances, they follow the Napoleonic code. The main industry is tourism, which sells duty-free goods to its neighboring residents. There are three types of business entities that can be formed and operate in Andorra:

1. A collective society (SRC), essentially a partnership. There are no capital requirements. However, one partner must be a native Andorrian.
2. A *societat anonima* (SA), essentially a large corporation. There must be real capital investment of 5 million in pesetas or the equivalent, with no more than 10 shareholders.
3. A *societate de responsibilitat limitada* (SL), essentially a small corporation. There must be real capital investment of 3 million pesetas or the equivalent, with no less than three shareholders.

A foreign national cannot own more than one third interest in any Andorrian company. Foreign nationals use Andorrians as trustees or nominees. Bank accounts can be opened in any amount and in any currency. Breach of bank secrecy is a criminal offense. Every bank offers a numbered account facility.

### 3.3.2 Anguilla

Anguilla is a British overseas territory about 190 miles east of Puerto Rico. The Virgin Islands (British and American) are not far away. The island is 35 square miles with a population of about 10,000. Tourism is the biggest source of foreign exchange. The governor is appointed from London, while the four ministers of government are locally appointed among the elected members of the House of Assembly. It is a democracy with elections held every 5 years. The Constitution of Anguilla with a Bill of Rights was created by the Order in Council of the British Privy Council. Anguilla's relationship with the European Union is governed by Britain's legislation and British agreements with her European partners. English is the language of Anguilla. The law is based on British common law, supplemented by local statutes enacted by the local house assembly. There are no currency restrictions in Anguilla. Commercial banks accept deposits in U.S. dollars, pounds sterling, and Eastern Caribbean dollars, the local currency. There is a 2% tax on any purchase of foreign currency. There are no restrictions on bringing foreign currency in or out of Anguilla. Also, there is no income tax, withholding tax, asset tax, gift tax, profits tax, capital gains tax, distributions tax, value-added tax, asset departure tax, inheritance tax, or estate duty tax. Professionals and banks in Anguilla are subject to the Confidential Relationships Ordinance, 1981, which imposes a criminal penalty for breaches of confidence. Shareholders and directors of ordinary companies must be published to the registrar of companies annually, but the common use of nominee shareholders holding shares under a trust agreement provides an additional layer of secrecy. Attorneys and banks require full disclosure of clients' names and backgrounds, but will not disclose such information without a court order or similar obligation. Banks require the source of funds to be identified in case of significant deposits. Money laundering is not encouraged by banks or professional advisers in Anguilla. Under the Mutual Legal Assistance Ordinance, 1990, the treaty between Britain and the U.S. has been extended to Anguilla. Corporations are established under either the Companies Ordinance, 1994, or the International Business Companies Ordinance, 1994. A limited-liability company may be registered under the LLC Ordinance, 1994. Its terms may be either perpetual or of limited duration, as provided by the LLC agreement. A public company is one that may be quoted on a stock exchange and is subject to stringent auditing and filing requirements. Limited partnerships in Anguilla are subject to the Limited Partnership Ordinance, 1994. Partners may be individuals, corporations, or other partnerships. One general partner of a limited partnership must be an Anguillian company or resident. The name must end with LP. A trust is a relationship recognized by rules of equity under the Trust Ordinance, 1994. There are rules for regulating spendthrift trusts, memoranda of wishes, purpose trusts, protectors, variation of terms, foreign trusts, and variant trusts. The rules against perpetuities are abolished. A trust may provide for beneficiaries to be added or excluded. If the settler and trustees are not resident in Anguilla, the trust is guaranteed to be exempt from taxes in Anguilla. There is one offshore bank and four banks having branches on the island. Anguilla has cable and wireless communications. There are airlines servicing Anguilla from San Juan, Puerto Rico, and St. Maarten.

### 3.3.3 Antigua and Barbuda

These two islands are east-southeast of Puerto Rico. Antigua is about 108 square miles and Barbuda is about 62 square miles. The two islands have a population of about 67,000. The

islands have a tropical climate. English is the official language of the islands. They have a constitutional monarchy with the queen of England as head and the English-style Parliament. The governor general is appointed by the English Crown. The prime minister and the cabinet are appointed by the governor general. The Senate consists of 17 members appointed by the governor general. The House of Representatives members are elected and serve 5-year terms. The islands gained independence from England in 1981. The legal system is based on English common law. Tourism dominates the economy. The currency is the East Caribbean dollar. There are good communications on the island and internationally. There are 16 Internet providers on the islands. They have paved roads, two good airports, and one seaport in St. John's. The islands are known for their offshore financial center. The International Business Corporations Act, 1982, provides for the formation of a company on the islands. An international business corporation (IBC) must have a minimum of one shareholder. There are low setup and renewal costs. There are no requirements for filing or submitting accounting or audit reports. There are no minimum capital requirements. However, one must maintain a registered office and agent in the country. There is no agreement on exchange of information with other countries.

### 3.3.4 Aruba

Aruba is an island nation situated approximately 12 miles off the coast of Venezuela in South America. Its capital is Oranjestad; its population totals about 65,000 inhabitants. Aruba is a small island measuring 19.6 miles long and 6 miles across at its widest point. Until January 1, 1986, Aruba together with Curaçao and some small islands formed part of the federation, which formed the country of the Netherlands Antilles. On that date, it acquired a separate status. Aruba has a parliamentary democracy with a governor representing the queen of the Netherlands. The Parliament consists of 21 members that are elected by universal suffrage. The Aruba legal system of civil and penal law is a copy of the Dutch legal system, a system derived from Roman law. The basic laws are the Civil Code (*Burgerlijk Wetboek*) and the Commercial Code (*Wetboek van Koophandel*). Besides these two principal codes, there are numerous laws, regulations, and directives. Because Aruba is part of the Kingdom of the Netherlands, all laws are in Dutch. The Aruban florin (or guilder) is divided into 100 cents. The Aruban florin is tied to the U.S. dollar at a rate of Af. 1.79. Papiamentu is the native language; however, Dutch is the official language. Most professional advisors speak English fluently. Dutch, English, and Spanish are widely spoken. French and German are also spoken. Professionals have mostly had either a Dutch or North American education. Aruba is an associate member of the European Economic Community (EEC). Aruba has excellent communications on the island. Automatic international communications are possible with most countries in the world. Telegraphic communication services are provided by SETAR, a government-owned company. There is also a data communications system through which several data networks in the U.S. and Europe are accessible.

The country has excellent telephone, telex, and cable communications, as well as daily connections by air with major cities in the U.S., Latin America, and Europe. There are a number of reputable international and local banks to service the financial needs of the tax haven sector. There are also many law firms, accounting firms, and trust companies established in Aruba. With the termination in 1988 of its treaty base, the Aruban government passed legislation for zero tax offshore company facilities in Aruba. Aruba is an attractive

tax haven in the Caribbean and Central American region because of political stability. All legal and natural persons carrying on a business enterprise in Aruba are subject to a number of obligations to provide the tax inspector's office with certain information. Numbered bank accounts are not permitted in Aruba. In order to open a bank account, one normally has to prove one's identity, or if the bank account is for a legal entity, a certificate of the Chamber of Commerce must be lodged.

There are two kinds of limited companies in Aruba, the *Naamloze Vennootschap* (NV) and the *Aruba Vrijgestelde Vennootschap* (AVV) or Aruba Exempt Company (AEC). Prior to the introduction of the AEC, all limited companies were NVs. There are many similarities between NVs and AVVs, but also fundamental differences. In general, it can be said that the Aruban zero tax company has a more modern corporate structure than the Aruban NV. The Aruban zero tax company provides an attractive vehicle for international tax planning because of the absence of taxes, relatively low cost of formation and maintenance, flexibility of its corporate structure, and absence of red tape and regulatory restrictions. The Aruba Exempt Company may not conduct business activities in Aruba other than those that are necessary in connection with the maintenance of its office in Aruba. The company is also prohibited from conducting banking, insurance, or any other activity that would make it a creditor of a financial institution under Aruban law. This rule applies regardless of whether the activities are conducted inside or outside Aruba. The required minimum capital is Afl. 10,000, which is approximately U.S.\$5,600. The company must be registered in the commercial register, which is open to the public. It contains the names and other personal data about the directors and legal representative. There are no currency exchange controls for AEC companies or foreign nationals and companies.

### 3.3.5 Bahamas

The Bahamas are located off of Florida's east coast. It consists of 700 islands, of which only about 40 are inhabited. The population is approximately 340,000. It is part of the British Commonwealth; however, it received its independence on July 10, 1973. There are no income, sales, capital, estate, or inheritance taxes. The Bahamas does have property taxes, which are assessed at 1 to 3% on nonresidents. Most of the Bahamas' revenue comes from Customs duties. It has exchange control to conserve its foreign currency resources and assist in the balance of payments. Exchange controls on nonresidents are nonexistent. The Bahamas uses the Bahamian dollar, which is tied to the U.S. dollar. There are good transportation and communications to both the U.S. and Europe. There are many branch offices of international banks in both Nassau and Freeport. The Bahamas has strict bank secrecy laws. No banker can disclose customers' affairs without an order from the Supreme Court of the Commonwealth of the Bahamas. The legal system is based on English common law and rules of equity. It has a parliamentary form of government consisting of the Senate and House of Assembly. The queen of England is the head of state and is represented by the governor general. The governor general appoints the Senate and prime minister. A Bahamian company can be formed with minimum formalities. For companies wanting to do business in the Bahamas, there are various types of licenses that need to be obtained. The International Business Companies Act of 2000 (IBC) has restrictions. IBCs cannot trade within the Bahamas or own real estate unless government permission is granted. They cannot undertake business in banking, insurance, investment schemes, trust management, trusteeship, or any other activity that would suggest an association with the

banking or insurance industries. Also, they cannot sell their own shares or solicit funds from the public. For nonresidents, only a resident agent is required to be in the Bahamas. The officers and directors of a Bahamian company can hold meetings anywhere. Directors can be as few as one, but two are better. Nominees can be used as directors and shareholders. However, all directors' names and addresses are to be registered in the public register. The Bahamas is not a party to any double tax treaties since it has no direct taxation of income, capital gains, gift, or inheritance taxes. There is no requirement to file audited accounts with authorities; however, a company is required to keep financial records that reflect the financial position of the company.

### **3.3.6 Barbados**

This country is an island in the Caribbean chain. It was a British colony until 1966, at which time it gained its independence; however, it remains part of the British Commonwealth. Its official language is English. The Barbados dollar is tied to the U.S. dollar at the rate of U.S.\$1 = BDS\$2. Barbados has an exchange control authority; however, it does not control companies operating in the offshore sector. Under the Offshore Banking Act, the affairs of nonresident customers are not to be disclosed. Share warrants are permitted. The names and addresses of beneficial owners of shares must be made to the Central Bank. The Central Bank keeps them confidential, although it is not a criminal violation for government officials or employers to reveal such information. Barbados has a tax information exchange agreement with the U.S. There are many international bank branches in Barbados. Transportation and communications from Barbados to the U.S. and Europe are good. There are regularly scheduled flights. Income tax is imposed on both individual and corporate domestic income. Foreign income is not taxed, except on residents. There is no capital gains or inheritance tax. Barbados also imposes withholding taxes on income derived within the country. Barbados has tax treaties with the U.K., U.S., Canada, Denmark, Norway, Sweden, and Switzerland. Barbados has a parliamentary form of government consisting of a Senate and House of Assembly. It follows the English common law and law of equities. The Companies Act allows for flexibility in forming, operating, and winding up or transferring the domicile of a company. Single shareholder and director companies are allowed. Board meetings can be held both within and outside Barbados. Shareholder anonymity can be achieved by using:

1. Nominees
2. Foreign trusts
3. Share warrants (a form of bearer stock)

### **3.3.7 Belize**

Belize (formerly British Honduras) is located next to southern Mexico and Guatemala by the Caribbean Sea in Central America. English is the official language, but Spanish is also spoken. Belize has a population of about 266,000. It has a tropical climate and is hot and humid. It is a democracy that won its independence from England in September 1981. The legal system follows English law. The governor general and prime minister are appointed by the queen of England. The leader of the majority party is usually appointed prime minister. The Senate has 12 members appointed by the governor general. The House of Representatives is elected by the electorate. There are 29 members in the House of



Representatives who serve 5-year terms. Tourism is the principal industry, followed by sugarcane, citrus, marine products, and bananas. There are good communications, internal and external. Belize has automatic systems for direct dialing, faxes, cellular communication, and e-mail, as well as two Internet service providers. It has both a seaport and airport. The International Business Company Act provides for privacy. Directors and shareholders of IBCs can remain anonymous and are not recorded other than companies' registered offices, which may not be divulged to any authority. Shares may be issued in bearer shares, and companies may have nominee directors. There are no restrictions on trade. Bank secrecy is enforced by law, and bank records cannot be made available to authorities in any jurisdiction. All normal banking services are available. A merchant can have credit card receipts credited to IBC offshore accounts. In Belize, IBC assets cannot be touched by any authority. Also, a trust can be set up for nominal costs and minimal formalities on short notice. The trust must be irrevocable to qualify as a true asset protection device. There is no requirement for accounting reports to any agency. Claims, judgments, liens, or bankruptcy proceedings from any country cannot be imposed upon earnings or assets of irrevocable discretionary Belize trusts. Another vehicle is the Suisse–Belize International Investment Trust. It operates in a manner very similar to that of a mutual fund, except with certain provisions. First, it is private, not public. Second, instead of shares, it issues bearer unit certificates. Since secrecy is paramount for this money, the certificates are not issued in name, but are the property of the bearer. This allows for transferability. To safeguard against stolen bearer unit certificates, the account number and password are required to validate the cashing in of a certificate. The Suisse–Belize Investment Trust operates under the Trust Act of Belize, 1992. There are no annual reporting requirements on this type of offshore international investment trust. To protect the trust, a standard form must be filled out and notarized declaring that the funds used to purchase the bearer unit are not from criminal or illegal activities.

### **3.3.8 Bermuda**

This country is located in the middle of the Atlantic Ocean about halfway between the U.S. and Europe. It is a self-governing colony of the British Commonwealth. Transportation and communications are very good to both the U.S. and Europe. The official language is English. Bermuda has exchange control authority on local residents. However, offshore companies and individuals can maintain bank accounts in the currency of the country that they choose. The government has restrictions on who can incorporate and do business there. There is no income, capital gains, or withholding tax. Nominees can be used to safeguard real beneficial owners. There are many branches of international banks on the island. Bermuda has its own monetary authority and dollar, which can be converted into any currency of choice. The legal system is based on English common law. The Companies Act allows for the formation of exempt companies, which are corporations that do not operate on the island. These exempt companies are not taxed, but they must maintain offices in Bermuda. An auditor located on the island must audit the books every year. There must be at least three shareholders. The shareholders must be registered in company registers, which are open to the public. Nominees can be used as shareholders.

### **3.3.9 Cayman Islands**

The Cayman Islands are located between Cuba and the Yucatan Peninsula. They form a British colony. The official language is English. Transportation and communications to

the U.S. and Europe are very good. There are no income, capital gains, estate, and inheritance taxes. Income is derived from import duties. The currency is the Cayman dollar, which is pegged to the U.S. dollar at CI\$1 = U.S.\$1.20. There are many branches of international banks on the islands. The Cayman Islands have bank secrecy laws. There are no currency exchange controls, and there are criminal penalties on government officials and professionals who make unauthorized disclosures of customers' accounts. The British government signed an agreement with the U.S. to prevent drug traffickers from enjoying benefits of the Cayman Islands' laws in 1984. The law provides a mechanism for obtaining evidence in federal court proceedings through the attorney general of the U.S. and the Caymans. The procedure must be strictly complied with and cannot be used in any other case or for any other purpose. There are no currency exchange controls. The Cayman Islands are politically and economically stable. The islands have a substantial trade surplus with the outside world. Employment and standard of living are very high. The islands have direct-dial telephone, telecopier, cable, Internet, and telex links. The postal service is efficient, with air courier services available to virtually all parts of the world. The Companies Act provides for exempt corporations. These are corporations that do not operate on the islands. An exempt corporation must have one meeting a year on the islands. It must also have at least one director. The company register is not open for public inspection. Nominee directors and shareholders can be used and are customary. Proper books are necessary to give a fair view of the company's affairs and to explain its transactions. An annual return is required by law, but it is not necessary that it be audited. Cayman trusts are governed by the Trust Law, 1976. A trust can be created by a resident of any country, and the settler does not have to be physically present on the islands. While the trustee should be located in the Caymans, it is not necessary to keep trust assets there. A stamp tax of U.S.\$50 is payable on a trust deed, but there is no requirement for public recording or registration. No statutory restrictions exist in the Caymans regarding accumulation of income, but the common-law rule against perpetuities applies, except in the case of exempt trusts. The trustee of an offshore trust should be a resident in the Caymans. An ordinary trust usually assigns a bank or trust company to act as trustee. Neither the settler nor the beneficiaries have to be physically present within the Caymans, and the trust's assets may be kept outside the islands. An exempt trust must pay an annual fee of U.S.\$120 each year, and the trustees must file with the registrar such accounts, minutes, and information as the registrar may require. Documents filed with the registrar are open to inspection by the trustees or any other person authorized by the trust and the registrar, but they are not open to public inspection. An exempt trust may provide for perpetuity of up to 100 years, and during its subsistence the beneficiaries have no interest, vested or future; all rights of the beneficiaries are vested in the registrar of trusts, who is an official of the Cayman government. Switzerland, Panama, the Bahamas, and the Caymans have well-established bank secrecy laws designed to prevent unauthorized disclosure of a client's financial affairs to outside authorities. The Caymans do not recognize tax evasion or avoidance as a crime, and in 1979 they reinforced the Confidential Relationships (Preservation) Law with heavier penalties for disclosure. The Caymans were the first to set up the limited-duration company. This is a corporation that is treated as a partnership for U.S. tax purposes, "enabling a flow-through," but without the complexity of the limited-partnership structure.

### 3.3.10 Costa Rica

Costa Rica is located in Central America. The official language is Spanish, but English is used in commercial practice. The country has a democratic form of government and no military forces. The national currency is the colon; there is exchange control on the colon, but there is no control of funds transferred into a Costa Rican account and maintained in a foreign currency account. The banks are required by law to maintain secrecy regarding the affairs of their customers. There are income, capital gains, and withholding taxes. Costa Rican law provides for foreigners to reside in Costa Rica, especially those on retirement income. The pensioned resident must reside in Costa Rica for at least 6 months per year. In addition, the pensioned resident can travel on a Costa Rican passport called a passport of convenience. Organized crime figures like this characteristic because they can go directly to Costa Rica when things get “hot” in the U.S. They in turn can travel to other countries using a Costa Rican passport instead of a U.S. passport. Costa Rican law establishes four different legal capacities in which people can engage in business:

1. Individual enterprise with limited liability, regarded as an individual
2. Collective company, similar to partnership in common-law countries
3. The limited partnership, a partnership that has limited liability
4. Stock corporation or chartered company, a corporation

The stock corporation can be formed with two or more incorporators. A single person may be the only shareholder. A stock corporation can issue bearer shares of stock. This allows the shareholder who wants to keep his identity from being known the assurance of secrecy regarding his investment. The bearer stock must be paid in full; otherwise, the shares must be registered with the public registry.

### 3.3.11 Cyprus

Cyprus has been an independent republic since 1960. It was previously a British colony. Cyprus is a member of the United Nations, British Commonwealth, and the Council of Europe. In 1974 part of the island was occupied by Turkish forces and is still occupied. This study does not relate to the area under Turkish occupation. The legal system is mainly based on English common law and equity. English case law is widely followed. The official language is Greek, but English is very widely spoken and used especially in court, government offices, and businesses. The economy after the Turkish invasion in 1974 has recovered and has surpassed its pre-1974 standard of living. Foreign investments are increasing, mainly in the industrial and tourist sectors. Political and economic stability is now rated as good. The Cyprus pound is divided into 100 cents; it is subject to fluctuation. Cyprus is not in the sterling area. There are very good air and sea communications. It has excellent telecommunications facilities with automatic connections with 69 countries and automatic telex communications with 148 countries. Cyprus is rated among the top five countries with excellent automatic telecommunications. A satellite Earth station started operating in 1980. There are also Marisat, facsimile, and datel services. Secrecy laws bind banks. Banks do not have numbered accounts. Cyprus has exchange control on residents, but it is not applicable for IBCs. The geographical position, the climatic conditions, the availability of local skilled personnel, and the low cost of living make Cyprus a very suitable place from which to manage offshore activities, especially for the Middle East. Cyprus has

double taxation agreements with 18 countries, which includes the U.S. Cyprus has an income tax on individuals and companies who operate on the island. Income earned offshore is not taxable. There are exchange controls for local residents and companies who do business on Cyprus. All foreign incorporated companies are nonresident. Foreign companies who do not have businesses on Cyprus are free from exchange control. Only local lawyers with a minimum of two shareholders can form corporations. There can be two classes of stock. Bearer shares are prohibited. Shareholders' names must be filed with the registrar of companies; however, nominees can be used. Cyprus has a network of double tax treaties that follows the Organization for Economic Cooperation and Development (OECD) model. This is beneficial for trade with certain East European countries, including Russia.

### **3.3.12 Dominica**

The Commonwealth of Dominica is a beautiful English-speaking country located in the Eastern Caribbean between the French islands of Martinique and Guadeloupe. Dominica was named and first sighted by Christopher Columbus in 1493 on his second voyage to the West Indies. Dominica is called the nature island of the Caribbean because its forest covers 60% of the country and it has 365 rivers and hot springs. It has a population of about 72,000. The country's infrastructure is good, with excellent water, power, and communications. It has direct-dial facilities worldwide via undersea fiber cable, and Internet and data transmission facilities. There are direct flights to Dominica from San Juan, Puerto Rico, Antigua, St. Lucia, and the French islands, with onward connections to North America and Europe. Dominica gained independence from Britain in 1978. A Westminster style of parliamentary democracy was adopted with elections every 5 years. The president is head of state, but the prime minister and his cabinet of ministers run the state. English is the official language. The legal system is based on English common law. Dominica passed the International Business Act in June 1996 and provides for the incorporation, operation, and regulation of IBCs. The act provides for total confidentiality, with civil and criminal penalties for any disclosure of information. There is no requirement for the disclosure of the beneficial owner to any authority. Bearer shares are allowed. There is no requirement to file audited financial statements with authorities. Online banking and trading accounts are available on the island. There are no exchange controls. The registry is closed; i.e., directors and shareholders are kept totally secret. Shareholder and director meetings can be held outside Dominica. Dominica is a member of the Eastern Caribbean Central Bank, which issues the Eastern Caribbean (EC) dollar. The EC dollar is fixed to the U.S. dollar at U.S.\$1.00 to EC\$2.6882. The U.S. dollar is also legal tender on the island.

### **3.3.13 Gibraltar**

Gibraltar is a British Crown colony situated at the southern end of the Iberian Peninsula. The legal system is based on English law using both common law and Acts of Parliament. The official language is English and all official documents are produced in English. The legal tender consists of currency notes of the Gibraltar government. U.K. currency is also legal tender. Gibraltar notes are not easily convertible outside Gibraltar. There are no currency exchange controls. There are no double taxation treaties and no provisions for exchange of information with any other country. There are excellent communications facilities and bank facilities. A corporation formed in Gibraltar can be exempted from

submitting an annual account to the commissioners of income tax, but it must apply for exemption. The corporation can remain exempt so long as no one is a resident of Gibraltar or the U.K. It can issue bearer shares of stock, but must be paid in full. The identities of persons applying for exemption must be kept secret.

### **3.3.14 Guernsey**

This is an island nation off the coast of England about 108 miles south of Southampton and about 40 miles from France. It is a British possession, but it has its own legal system and government. Committees of the state generally administer public services and departments. The island's law is the customary law of the Duchy, which dates back to the Normandy customary law. The customary law of Normandy is nowadays significant in matters of succession and real property. In taxation and commercial legislation, English acts are followed, especially in matters of investor protection. The U.K. negotiated special terms upon accession to the Treaty of Rome within the framework of Article 227 of the treaty, as amended by the Treaty of Accession. The arrangements, which are set out in protocol 3 of the Treaty of Accession, have the effect of retaining fiscal independence of Guernsey and freedom from the imposition of duties and levies, in particular value-added tax. There is no requirement upon Guernsey to adopt community fiscal, commercial, or economic policies. English is the official language; however, many laws have been enacted in French. Many law firms and staff are fluent in French and English. The currency is sterling, and both English and local notes are circulated freely. The economy of Guernsey is based on horticulture, tourism, finance, and light industry. Guernsey is dependent upon communications. It has stable links with the U.K., Jersey, and Continental Europe. Telecommunications and postal services are cheaper than mainland services and are available at most professional offices and banks. There is no local legislation enacted relating to secrecy of information, but English common law, which imposes a duty upon a bank and bank personnel to maintain secrecy, is applicable. Nominee and numbered account facilities are available. The double taxation agreements with Jersey and the U.K. do provide for exchange of information, but only to the revenue authority of those jurisdictions, respectively. Guernsey has a low income tax of 20% on any income that is derived or remitted to Guernsey. Companies and individuals are liable for income taxes if they are residents for a year or conduct a substantial part of their business there. An individual is a resident if he spends more than 182 days in Guernsey. There are no exchange controls on the island. At least seven people must form a corporation. Their names, addresses, nationalities, and domiciles are filed with the law officer of the Crown in court on Thursdays. Annual reports are required to be sent to the greffier not later than January 31 of each year. These reports must identify shareholders and their respective holdings. Annual meetings must be held in Guernsey.

### **3.3.15 Hong Kong**

Hong Kong is situated on the southeast coast of China, 90 miles southeast of Canton and 40 miles east of the Portuguese province of Macau. The total land area is 404 square miles. The estimated population in 1987 was about 5.6 million, of which 98% were Chinese. Great Britain and the People's Republic of China signed an agreement in 1984 that allowed Hong Kong to revert back to the control of China on July 1, 1997. This joint agreement provided for Hong Kong to remain a separate Customs territory after

June 30, 1997. Hong Kong has experienced dynamic economic growth since the end of World War II. Hong Kong is the third largest financial center in the world, after New York and London. The Hong Kong government has a policy of nonintervention in the financial sectors. English common law and rules of equity apply in Hong Kong to the extent that they are applicable to local circumstances. English acts have force in Hong Kong by virtue of their own terms, or by an order of the legislative council of Hong Kong. Chinese and English are the official languages of Hong Kong. Most important documents are published in both languages, and are required in many instances. There is no central bank in Hong Kong, but Hong Kong currency notes are issued by two commercial banks. On June 6, 1972, the Hong Kong government decided to quote the Hong Kong dollar in terms of the U.S. dollar. Hong Kong is not a tax haven per se, but an area with a low-tax structure. There are no residency or nationality restrictions regarding the ownership of real estate in Hong Kong. There are no exchange controls or restrictions in force. Banks and their personnel maintain secrecy as a matter of custom and not by law. Hong Kong has not entered into any double taxation agreements with other countries. Transportation and communications are among the best in the world. There are regularly scheduled flights to and from Hong Kong to most of the major cities around the world. A corporation can be formed with no less than two subscribers. It can have different classes of stock. Nominees can be used to hide true identities of shareholders. There are no nationality or residency requirements, nor any requirements to disclose beneficial interests. Annual returns must be filed with the registrar of companies, which must disclose the shareholders of the company. Minutes of shareholder meetings must be kept in Hong Kong and be open to inspection. Director meetings can be held anywhere in the world and are not open to inspection. At least two directors must be shareholders.

### **3.3.16 Isle of Man**

The Isle of Man lies in the Irish Sea and forms part of the British Isles but not the U.K. It is a possession of the British Crown, but remains self-governing. The island is within the European Economic Community (EEC) as far as free trade in agriculture and industrial products are concerned, but is outside the EEC for all other aspects of the Treaty of Rome. There are scheduled flights to and from London, Manchester, Liverpool, Glasgow, and Blackball. There are also regularly scheduled ferries to Liverpool and Heysham. There are normal telephone and telex services available worldwide. The currency is the pound sterling, which the government issues through the Isle of Man Bank Ltd. English, Scottish, and Manx notes are all in circulation. There are about 30 international banks that have branches on the island. They offer a wide range of services. There is a double taxation treaty of mutual disclosure with the U.K. Bank secrecy is a matter of custom and not law. There is an income tax on resident individuals and associations and nonresidents whose income is derived from the Isle of Man. There are no gift, estate, and capital gains taxes or stamp duty (document tax) on the island. There are no exchange controls either. Two or more people can form a private corporation. The corporation must keep a register of all shareholders. For residents outside the Isle of Man, this register is called a dominion register. All corporations must have two directors and also hold shares. Annual reports are required and must show the names and addresses of shareholders and their registered office. A registered office must be located on the island.

### 3.3.17 Jersey

Jersey is the largest of the channel islands that is situated in the English Channel. It is 103 miles south of Southampton and 14 miles from the coast of France. The business center is in St. Helier. There is a busy passenger and cargo port at St. Helier providing services to England, France, and the other islands. There are frequent and regular air services to London, Paris, and other airports in the U.K., France, and Ireland. Jersey has a long history of political and economic stability. The currency is the sterling. Jersey does not like the term *tax haven*. It prefers to be known as a finance center and has the attitude of maintaining respectability and protection of investors' dealings on the island. There are no exchange controls, and there is no legislation on secrecy of information or bank secrecy, but bankers and professional advisors can use numbered bank accounts and nominees. There is a 20% income tax on resident individuals and businesses, which has remained constant since 1940. English and French are the official languages. Most legal firms maintain principals and staff fluent in French and can translate French into English. There are many international banks on the island. Three or more people are required to form a corporation. At least nine shares must be issued and paid up. The share capital can be in any currency. There are no nationality or residence requirements for shareholders. However, a register of shareholders must be kept at the registered office and be available for public inspection. There is no requirement to disclose nominee holdings. Annual reports reflecting names and addresses of shareholders are required to be filed with the company registry.

### 3.3.18 Liberia

The Republic of Liberia was established in 1847 and has enjoyed independence and a stable free enterprise economy since its formation. The official language of commerce and government is English. The U.S. dollar is legal tender. There are no currency regulations or exchange controls. There are excellent transportation and communication facilities. Liberia has several of the most modern seaports in the world. There are no bank secrecy laws; secrecy is a matter of custom and not law. Liberians are subject to the Liberian Internal Revenue Code. Liberia has a tax law that attracts incorporation of Liberian companies by foreign investors. Corporations that qualify are not required to file income tax returns. Liberian corporations do not incur income tax liability in Liberia if not more than 25% of the stock is owned by residents, and the company does not carry on operations in Liberia. Anyone can form a corporation in Liberia. A single person can form a corporation. It can issue bearer stock if fully paid. Only the registered agent must be present in Liberia. No annual reports are required to be filed with any government agency. Shareholder and director meetings can be held any place in the world.

### 3.3.19 Liechtenstein

This country is located between Switzerland and Austria. It became an independent state in 1719 by the union of the two imperial baronies of Vaduz and Schellenberg. It obtained full independence in 1806 when it joined the Confederation of the Rhine that was founded by Napoleon. After World War I, Liechtenstein drifted away from Austria, with whom a Customs union had existed, toward Switzerland. Liechtenstein joined the Swiss Customs area and the Swiss Franc became the country's official currency. The official language is

German, but English is used in the economic sectors. It has a democratic form of government. It has taxes on income, property, estate, gifts, motor vehicles, alcoholic beverages, etc. There are no currency exchange laws or regulations. It does permit bearer securities, bonds, and stock. It has bank secrecy laws. Bankers are forbidden to disclose customers' financial affairs. Transportation and communications are good. Peculiar to Liechtenstein is its law relating to associations of persons and the company without juridical personality, which is codified in the Laws on Persons and Companies (PGR) code. The PGR code provides for a number of different kinds of corporate associations. The focal point of these legal forms, with their tax advantages, lies in holding companies and domiciliary enterprises. Holding companies and domiciliary enterprises are tax law concepts that designate enterprises operating in Liechtenstein that are liable for capital and revenue taxes. These forms include:

1. Companies limited by shares
2. Private limited companies
3. Establishments
4. Trust enterprises
5. Foundations

The PGR code also provides for limited partnerships with share capital, companies limited by quota shares, associations, cooperative associations and others, and companies without juridical personality. The PGR code contains only a few mandatory provisions. The features of the holding company and domiciliary enterprise with their own juridical personalities are:

1. The name and references to their legal form may be entered into the public register in a foreign language.
2. One member of the board of directors must be a Liechtenstein citizen residing within the principality and also be a lawyer.
3. They are exempt from property, income, and revenue taxes and subject to only capital tax, at a beneficial rate.
4. There must be a representative (registered agent) residing in the principality.

The establishment is an autonomous fund with its own juridical personality and for whose commitments only the resources of the undertaking are liable. It has no members, shareholders, or participants of any other kind, and no capital distributed in share form, acknowledging only beneficiaries, i.e., persons who draw economic advantage from it. The establishment is referred to as *anstalt*. The establishment may be authorized to issue its own shares, in which case it comes closer to a corporation. The formers of an *anstalt* may be natural persons or juridical entities with residence in Liechtenstein or abroad. The founders must draw up and sign articles, in written form, that contain the following:

1. Company name, including the designation *anstalt*
2. The establishment's domicile, objects, and capital, and the powers of its supreme governing body
3. The appointment of bodies for management and supervision
4. The principles for preparing financial statements



#### 5. The form in which notices are published

The objective of the *anstalt* must indicate whether the business will engage in commercial activities or investment or management of assets. The capital may be expressed in foreign currency, but must be at least 30,000 Swiss Francs (Sw.Fr.) or equivalent. The bearer of the founder's rights constitutes the establishment of a supreme body. The supreme body can:

1. Appoint or dismiss the board of directors and auditors
2. Determine the signing powers of management
3. Approve the financial statements
4. Change the articles or bylaws
5. Determine beneficiaries and their rights
6. Appoint or dismiss the legal representative

The establishment's beneficiaries are the people to whom the profit and benefit of the establishment accrue — who are entitled to the income, the individual assets, and the eventual liquidation proceeds. Unless third parties are nominated as beneficiaries, the law assumes that the bearer of the founder's rights is the beneficiary.

### 3.3.20 Luxembourg

The Grand Duchy of Luxembourg is situated in Western Europe, lying between Belgium, France, and Germany. The capital city, also called Luxembourg, is the government, business, and financial center. Transportation is good since Luxembourg is in easy reach of all of Europe's road, rail, and air services. It is also linked directly to the Northern European seaports through the river Moselle and the European canal system. Communications are also good, with direct dialing with most of Europe and the U.S. Luxembourg has developed a sophisticated banking sector. There are more than 115 international banks operating in Luxembourg. In recent years, Luxembourg has become a center for Euro-bond issues. Luxembourgish is the spoken language, and French, German, and English are widely used in official and business circles. French is used in administration, while many laws still exist in German. The currency is the Luxembourg franc, currently on a par with the Belgium franc, which is also legal tender in Luxembourg. Luxembourg has no central bank, although the Luxembourg Monetary Institute has been created, which is entitled to issue 20% of the money in circulation and rediscount bills held by Luxembourg banks. The laws are based on the Napoleonic code, and the legal system has much in common with Belgium and France. It is common practice in Luxembourg for registered companies to issue bearer bonds or shares that can be held or deposited anywhere in the world. Bank secrecy with numbered accounts is normal and respected. It is governed by civil law. Luxembourg has double taxation treaties with 15 countries under which information may be exchanged. The U.S. is one of those countries. Holding companies are the most commonly used in Luxembourg. The ordinary holding company pays no corporation, income, capital gains, wealth, withholding, or liquidation tax. Exchange control regulations are in effect with the Central Bank in Brussels. Local banks are entrusted with the control of financial transactions based on the directives of the Central Bank.

### 3.3.21 Malta

Malta is composed of three islands south of Sicily in the Mediterranean Sea. The islands are approximately 122 square miles. It has mild and rainy winters and hot and dry summers. It has a population of about 400,000. Maltese are mainly descendants of ancient Carthaginians and Phoenicians with strong Italian. It is mostly a Roman Catholic country. English is the official language. It gained independence from Britain in 1964. Its legal system is based on English common law and Roman civil law. The president is elected by the House of Representatives for a 5-year term. The leader of the majority party is appointed prime minister. The representatives are also elected for 5-year terms. Judges are appointed by the president on the advice of the prime minister. Malta is dependent upon foreign trade. Tourism, electronics, ship building and repair, and textiles are its major industries. It is currently contemplating entry into the European Union. It has good communication, both internal and external. There are two Internet service providers. Roads are good and paved. It has an excellent seaport and airport at Valletta. However, it is a minor transshipment point for hashish from North Africa to Western Europe. Malta is a host of many foreign banks, mostly from Europe and the Middle East. The two local banks are the Bank of Valletta, Ltd., and Mid-Med Bank, Ltd. Major credit cards are honored on the islands. In 1996, a new form of company structure was introduced to cater to the growing demands of nonresidents who wished to establish their business or holding interest in Malta. The international trading company (ITC) is a normal onshore Maltese company with no distinction from other local companies. ITCs are taxed at the normal corporate tax rate of 35%. However, nonresident shareholders may benefit from partial refund of tax, potentially reducing the incidence of tax to 4.17%. An international holding company (IHC) is a company resident in Malta, formed with the objective of holding overseas investments and distributing that income to nonresidents. Nonresident shareholders of IHCs qualify for a full refund of the Maltese tax paid by the company on profits and gains arising from participating holdings when such profits are distributed. Requirements for incorporation in Malta require a minimum capital of U.S.\$1,500, with a minimum paid-up share capital of 20%. Nominee shareholders are permitted. Only one director is required. One general meeting each year is required. There are no exchange controls if the company is fully owned by nonresidents. Companies can do business in any currency. However, an annual return with audited financial statements is required. Malta has targeted online, offshore betting operations. Maltese betting operations are carried out through an ITC set up for the purpose. Nonresident shareholders are taxed at 4.17%. Betting transactions are taxable at 0.5% on turnover. There are no license fees or application fees. Betting licenses are granted to persons having the appropriate business ability to conduct betting offices successfully. Licenses are issued for 5 years and are renewable. A special law was enacted to allow for the setting up of trusts. The advantages of trusts in Malta are favorable taxation, confidentiality, control of assets, no probate, and investment income from trusts can be accumulated tax-free. Trusts must be in writing. Neither the settler nor beneficiaries can be residents of Malta. The trust property shall not include immovable property situated in Malta. The trust instrument is a highly confidential document, and no person may be ordered to divulge to any authority, including any court of any manner, relating to a trust. The Professional Secrecy Act, 1994, prohibits any lawyer, banker, stockbroker, or accountant from divulging any information about his or her clients unless there is international criminal activity (money laundering, drug dealing, etc.) involved.

### 3.3.22 Mauritius

Mauritius is a mountainous subtropical island in the Indian Ocean with an area of approximately 788 square miles. It lies about 800 kilometers east of Madagascar. The capital is Port Louis. It has a tropical climate with warm, dry winters and hot, wet, humid summers. Mauritius has a population of 1,210,000, which is mostly Indonesian. Creole is the second largest group. English is the official language, even though French, Creole, and Hindi are spoken. The British took possession of the islands in 1810. Mauritius gained independence in 1968 and became a member of the commonwealth. The queen was head of state until March 12, 1992, when Mauritius became a republic. The head of state is the president who is elected by the National Assembly and serves a 5-year term. The prime minister and cabinet are appointed by the president. The National Assembly is elected and members serve 5-year terms. The legal system is based on French civil law, with elements of English common law in certain areas. Mauritius has developed to a middle-income diversified economy with growing industrial, financial, and tourist sectors. Sugarcane is the major agricultural business. Mauritius has good telecommunication facilities, including cellular phone service and two Internet service providers. It has good roads, one good seaport, and two good airports. There are two types of companies used for international tax planning: the international company (IC) governed by the International Companies Act and the offshore company (OC) governed by the Mauritius Companies Act of 1984. Offshore banks and insurance companies cannot operate as ICs. OCs need not make annual returns, but must file audited profit and loss statements and balance sheets with the offshore authority. Every Mauritian company must have a registered office in Mauritius. The registered office must have accounting records and certain documents, including a register of members, debenture holders, and officers, and must keep them there. OCs must have a minimum of two individual shareholders and hold annual general meetings. The meetings need not be held in Mauritius. Incorporation takes up to 14 days. The ICs cannot transact business in Mauritian rupees with Mauritian residents. They cannot be used for public, banking, insurance, or fund-related activities or to access Mauritius double taxation agreements. An IC can be incorporated on the same day. The identities of the beneficial owners need to be disclosed only to the management company. There are no requirements to file annual accounts and returns, or to hold director and shareholder meetings. The IC is not resident in Mauritius, and therefore not liable to tax. An OC can be converted to IC and vice versa. The Mauritius offshore trusts may be created by oral declaration or by writing. To be enforceable, the declaration of trust must be registered with the Mauritius Offshore Business Activities Authority (MOBAA). There are no forced heirship rules. The perpetuity rule is 100 years from the date the trust came into existence. There is no disclosure of trustees' deliberations or the names of the settlers and beneficiaries unless the latter are Mauritian residents. Claims against the trust assets must be made within 2 years of settling a property into the trust. Under the Maruitius Finance Act, 1996, a nonresident trust and nonresident beneficiaries will be exempt from tax and all filing requirements. Charitable trusts are exempt from taxation.

### 3.3.23 Montserrat

Montserrat is an island east of Puerto Rico and the U.S. Virgin Islands. The island is a dependent territory of the U.K. with an appointed governor by the British government. Montserrat has a history of political stability. The legal system is based on the common

law of England. The local and official language is English. The economy is based on agriculture, light industry, and tourism. Tax incentives are available for new business enterprises on the island. The Eastern Caribbean dollar is the official currency, although the U.S. dollar and the sterling are circulated. The EC dollar is tied to the U.S. dollar and is fully convertible. The government has provided incentives for businesses to operate on the island: it offers tax holidays and duty-free imports. The Confidential Information Ordinance, 1985, provides heavy penalties for unauthorized revealing of information. Montserrat has double taxation treaties through the extension of some of the U.K. treaties with the governments of Canada, Denmark, Japan, New Zealand, Norway, Sweden, and Switzerland. Two local banks, Barclays and the Royal Bank of Canada, do not permit numbered accounts, although there are no legal bars against them. Corporations can be formed under the provisions of the International Business Companies Ordinance, 1985. This provides that only one subscriber is necessary. There are no restrictions on the transfer of shares or the number of shareholders or debentures. The memorandum of association must include the name of the company (which must contain *Limited*), registered office in Monserrat, purpose, authorized capital, and number of shares. A registered office must be maintained on the island. Annual reports must be filed with the registrar of companies for private companies, but none are required for international business companies. Bearer stock is allowed provided that it is paid in full. Annual meetings of shareholders and directors can be held anywhere in the world. All international business companies are specifically exempted from exchange control. Monserrat is part of the Eastern Caribbean banking network. There are good air and sea transportation facilities. Communication facilities are also good.

Recently, a volcano erupted on the island, which sent many residents fleeing to neighboring islands. The British government asked the remaining residents to move off the island, since it is expected that the volcano will erupt again. This island may become deserted, which will leave its tax haven status in doubt. Currently, the government and businesses are still operating, but only at the end of the island not affected by the volcano.

### 3.3.24 Niue

Niue was formerly called Savage Island. This island is in the South Pacific, east of Tonga. Niue is dependent upon New Zealand for financial support. It is only 100 square miles with a population of about 1,800 people. It has no paved roads, only one airport, and no seaport. Ships have to anchor offshore. The economy is heavily dependent upon New Zealand. The sale of postage stamps to foreign collectors is an important source of revenue. There are no exchange controls. English is spoken, but the indigenous language is a Polynesian tongue closely related to Tongan and Samoan. Niue provides a jurisdiction in an alternative time zone to the Caribbean, as well as certain features embodied in the international business corporation law favorable to clients in Asia and the former Soviet Union. Niue offers total secrecy and anonymity. There is no requirement to disclose beneficial owners or to file annual returns or financial statements. There is no requirement to hold annual general meetings of shareholders or directors. Full exemption from taxation is given to any business activity or transaction carried on outside Niue. There are no minimum or maximum capital requirements. Companies may use different classes of shares at the owners' option. Another virtually unique feature is the facility for the company name to be incorporated in Chinese characters as well as Cyrillic script and other accepted

language forms (with an English translation). Foreign companies may be redomiciled as Niue IBCs. Names and suffixes available to indicate a corporation include Limited (Ltd.), Corporation, (SA), Incorporated (Inc.), A/S, NV, BV, GmbH, and Aktiengesellschaft (AG). A problem for Niue is the loss of population to New Zealand. There are 20,000 Niueans living in New Zealand who believe that Niue will have to surrender its independence and return to New Zealand since the island has no economy. Niue's tourism and tax haven status do not sufficiently support the island nation. New Zealand makes up the shortfall in its budget.

### **3.3.25 Nauru**

The smallest country in the world, Nauru became an independent sovereign state on January 31, 1968, and subsequently an associate member of the British Commonwealth. It is in the center of the Pacific Basin, located about equidistant from Sydney, Australia, to the southwest and from Hawaii to the northeast. Nauru has close educational links with Australia. Nauru has a democratic government with an elected parliament and president. It has a well-developed and efficient civil service and judicial system. The airline Air Nauru connects Nauru with Australia, Fiji, Hong Kong, Manila, Honolulu, and other Pacific islands on a regular basis, usually twice a week. Nauru is well connected through a satellite in order to render telephone, cable, telex, and facsimile services to and from the principal cities of various countries, including the U.S. The official currency of Nauru is the Australian dollar, which is freely convertible into different currencies. Nauru designed legislation with the intent to provide facilities for tax planners. It wants to help entrepreneurs both new and existing to generate and mobilize their resources for economic expansion. At the same time, it guards against fraud on creditors, investors, depositors, and shareholders. It offers full freedom for entrepreneurs to establish holding and trading companies, but does not hesitate to terminate the corporate existence of those corporations that carry out fraudulent business within or outside Nauru. Corporations offer the following advantages.

1. Minimum formation time (24 hours)
2. Low formation costs
3. Minimum pre- and postincorporation legal formalities
4. Low capitalization
5. Freedom to issue bearer shares
6. Complete secrecy of operations
7. Anonymity of promoters

A resident secretary is required by statute. Shares usually must be stated in Australian currency, but there are some exceptions. Annual reports are required to be filed with the registrar. The reports only require the names of directors, secretaries, and the registered agent.

### **3.3.26 Netherlands Antilles**

This country is located off the coast of Venezuela. It is dominated and controlled by the Netherlands. The Netherlands Antilles is also part of the EEC. These islands have their own island government. The official language is Dutch; however, English, German, French,

and Spanish are used. The monetary unit is the Netherlands Antilles guilder. It is pegged to the U.S. dollar at \$1.79 per one guilder. Identities of shareholders are not available for public inspection until all issued shares of stock have been fully paid up. Income tax is imposed only on income derived within the Netherlands Antilles. Currency exchange is only imposed on individuals and corporations doing business within the Netherlands Antilles. Transportation and communications are very good. The government does not mandate bank secrecy; however, it is bankers' custom to regard their customers' affairs as confidential. A limited-liability company (NV) is allowed to issue bearer shares, but they must be fully paid. Shareholder meetings must be held in the Netherlands Antilles, but proxy can represent them. It requires two or more people to incorporate. The managing director (*directeur*) must be a resident of the island. He serves as the registered agent. Financial reports are required to be filed with the commercial registry if (1) the corporation has issued bearer shares exceeding 50,000 guilders, (2) the corporation has issued shares or bonds on a stock exchange, or (3) the corporation borrows from third parties. Auditors are required to audit the financial statements. Only auditors from the Netherlands Antilles can be used.

### 3.3.27 Nevis

This Caribbean island lies east of Puerto Rico and west of Montserrat. It is a democratic country that is part of the British Commonwealth. Britain is responsible for external affairs and defense. Nevis is part of the Federation of St. Kitts and Nevis. The judicial commonwealth of the privy council of Great Britain is the court of ultimate jurisdiction and consists of members from the House of Lords. The official language and language in use is English. Nevis is self-sufficient in food production, but has a trade deficit. The government is seeking diversification through expansion of tourism, fisheries, light manufacturing, and offshore financial activities. The currency is the Eastern Caribbean dollar. It is pegged to the U.S. dollar at EC\$2.70 = U.S.\$1. The EC dollar is not an internationally traded currency. The adoption of the Nevis Business Corporation Ordinance, 1984, signified the government's commitment to become a modern tax haven. The ordinance provided that businesses conduct no commercial business on the island. Corporations can be formed in 24 hours. The government adopted the Confidential Relationships Act, 1985, which is applicable to office of the registrar of companies and professionals engaged in related services, financial and otherwise. There are no treaties respecting information exchange. Numbered bank accounts are not available through Nevis banks. Corporations formed under the Nevis Business Corporation Ordinance are not subject to exchange controls. Exchange controls on the EC dollar are in effect when exchanged for foreign currency. Transportation and communications are good. There are regularly scheduled flights to other major islands in the Caribbean basin. Only two people are required to form a corporation. The articles of incorporation must show the names and addresses of the incorporators and the initial directors. Bearer stock is authorized, but must be paid in full. There must be three directors, but they can be of any nationality or domicile. There is no requirement to show the names of subsequent shareholders or directors. Shareholder and director meetings can be held anywhere in the world. A registered agent is required to be a resident of the island. Most corporations use the Corporate Services Company in Charlestown, Nevis, as their registered agent. No annual reports are required to be filed.

### 3.3.28 Panama

This country is located in Central America, north of Colombia. It has an area of approximately 76,900 square kilometers. The official language is Spanish, but English is spoken in urban areas and used in daily commerce. Transportation and communications are excellent. Panama is supposed to have a democratic form of government; however, it has had dictators during the past several decades. The U.S. military invaded Panama in December 1989 and removed General Manuel Noriega. The currency of Panama is the balboa; however, since there is no balboa currency, the U.S. dollar is circulated and accepted as the medium of exchange. The judicial system follows English common law. Panama has income taxes, but they are imposed at the provincial level. Income derived outside Panama is not taxed. There are no currency exchange controls in Panama, and there are no bank secrecy laws, but custom has it that bankers regard their customers' affairs as confidential. A corporation can be formed by as few as two people and be of any nationality or domicile. Bearer shares can be issued. The full names and addresses of directors must be recorded in the public registry office. Every corporation must have a resident registered agent, which is generally some lawyer in Panama. There is no requirement for general or special meetings of shareholders or directors. The directors can be of any nationality or domicile. There must be three directors; they do not have to be shareholders.

### 3.3.29 Switzerland

This country is located in the heart of Europe. Switzerland has three official languages: German, French, and Italian. English is not used for official documents, but is used in official correspondence. This is a democratic country. The currency is the Swiss franc. Transportation and communication to and from Switzerland are excellent. The banks guard their customers' financial accounts. Switzerland has income, estate, capital gains, and inheritance taxes on residents. There are no currency exchange controls. The substantive law of Switzerland is codified. The civil and commercial codes are applicable throughout Switzerland. While the law is based on federal and cantonal legislation, court decisions and precedents play an important role. Foreign nationals can open numbered bank accounts in most banks. Switzerland does have double taxation treaties with many countries, including the U.S. Three or more individuals or companies can form a Swiss corporation. Their nationality and residence do not matter. Corporations must have a minimum capital of 50,000 Sw.Fr. and be paid up 20,000 Sw.Fr. They can have either ordinary shares or preference shares. Both classes of stock can be bearer or registered shares. Shareholders can use nominees. Shareholder names are not allowed to be identified to third parties or fiscal authorities. Auditors in Switzerland must audit the financial statements. They can only release their results to directors and shareholders as a group. The registered agent must be a resident of Switzerland and his or her name be published in the *Commercial Gazette*.

### 3.3.30 Turks and Caicos Islands

The Turks and Caicos Islands lie about 100 miles north of Haiti and the Dominican Republic. They are a British Crown colony under the jurisdiction of the British government. The British government appoints the governor. The legal system is based on British common law. Ultimate appeal is the privy council, sitting in London. English is both the official

and spoken language. The U.S. dollar is the official currency in the islands. The Turks and Caicos government enacted the Companies Ordinance, 1981, to establish the islands as a major offshore center. The government has a strong desire to attract offshore financial and business activity. The principal banks on the islands are Barclays Bank International and the Bank of Nova Scotia. There is no central bank. The economy is based primarily on tourism, offshore business, and fishing. There are good transportation and communications. There are regularly scheduled flights to the U.S. and other islands. Direct-dial service is available on the islands. Bank secrecy is a matter of custom and not law. The Turks and Caicos Islands have no income, capital gains, corporate, sales, property, withholding, payroll, inheritance, gift, or estate tax. The islands get most of their revenue from import duties. The Turks and Caicos Islands enacted the Narcotic Drug Ordinance, 1986, under which the attorney general of the U.S. may certify to the attorney general of the Turks and Caicos that certain documents and testimony are needed for grand jury investigation of narcotics offenses. The islands can compel both public and private sources to comply with requests. The islands do not want to become a haven for drug traffickers. An exempt company is one that does not operate on the islands. Only one shareholder is necessary to form an exempt corporation. The corporation can be formed without going to the islands. Annual reports are not required, and the corporation does not have to hold either shareholder or director meetings. A registered agent is required to be on the island. Identities of shareholders and directors are not shown in public records. Bearer shares can be issued.

### **3.3.31 Vanuatu**

Vanuatu is an independent democratic republic. It was formerly called the New Hebrides when it was part of the British Commonwealth. Vanuatu lies east of Australia. English and French are widely used, together with Bislama. Bislama is the official language. The official currency is the Vatu, which is linked to special drawing rights (SDR) (1 SDR = 110 VT). In 1985, 106 VT = U.S.\$1.00. Exempt companies under Vanuatu law are secret companies, and breach of that secrecy can entail fines and imprisonment. There are no taxes on income and capital; thus, there are no double taxation treaties with other countries. Number accounts are not available in Vanuatu. It takes only three days to two weeks to set up a company. Exempt companies are not allowed to do business in Vanuatu. Every company is required to keep a register of members, directors, and officers and proper books of account on the island. Annual reports are required to be filed every year. For exempt companies, these records and reports are to be kept secret. It is against the law for any government official to disclose this information. An auditor and registrar are required for all companies on the island. Exempt companies are not required to have an auditor, but must have a registrar. Shareholders' and directors' names of an exempt company are not available to the public. There is no income or capital gains tax on the island. There are no exchange controls. Bank accounts can be kept in foreign currency.

### **3.3.32 British Virgin Islands**

These islands lie just east of Puerto Rico in the Caribbean basin. They consist primarily of four islands: Torola, Anegada, Virgin Gorda, and Jost Van Dyke. The main and largest city is Road Town. The official and common language is English. The British Virgin Islands are a part of the British Commonwealth. The British government appoints the governor.



Its main industry is tourism. Transportation is good. There are regularly scheduled flights to Puerto Rico, Miami, and other Eastern Caribbean islands. Communications are also good. There is direct-dial telephone service to Puerto Rico and other countries. Sterling is the main currency; however, U.S. dollars are also accepted. There are no exchange controls, no central bank, and no income, capital gains, gift, or estate tax. The primary source of revenue is import duties. The government encourages foreign investment and capital. Banking and finance in the islands are the same as in the Turks and Caicos Islands. The legal system is also the same for the British Virgin Islands as it is for the Turks and Caicos Islands. An international business company is a corporation that does no business on the islands. A single individual can incorporate in the British Virgin Islands. Bearer stock is allowed, but must be paid in full. Annual reports for exempt companies do not reflect names and addresses of shareholders or directors. A registered agent is required and is a resident in the islands. Shareholder and director meetings can be held anywhere in the world.

### **3.4 Mutual Legal Assistance Treaties**

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Mutual legal assistance in criminal matters treaties (MLATs) are a relatively recent development. Their purpose is to obtain judicial assistance and to regularize and facilitate procedures. Treaty members designate a central authority, usually justice departments, for direct communication. The treaties include the power to summon witnesses, compel the production of documents and other real evidence, issue search warrants, and serve process. Generally, the remedies offered are only available to prosecutors. The defense must usually proceed with the methods of obtaining evidence in criminal matters under the laws of the host country, which usually involve letters rogatory. The U.S. has entered into MLATs with some tax haven countries: Antigua/Barbuda, Bahamas, Barbados, Hong Kong, Luxembourg, Montserrat, Panama, St. Kitts–Nevis, and Switzerland. The treaty with the U.K. extends to the Cayman Islands, British Virgin Islands, and Anguilla. These MLATs allow the governments to exchange information on criminal matters. However, most of the MLATs do not allow the exchange of information involving tax evasion. In fact, evidence acquired under MLATs cannot be used in either criminal or civil tax matters. One purpose of these treaties was to overcome the bank secrecy laws. Those individuals or organizations involved in illegal activities in tax haven countries are becoming more transparent.

### **3.5 Financial Action Task Force**

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The Financial Action Task Force (FATF) is an international organization of 31 nations. It was created in 1989 for the purpose of coordinating international money laundering efforts. The FATF's most significant accomplishment has been the establishment of financial intelligence units in 58 countries, which share financial information without resorting to courts. It initially had blacklisted 19 countries with bank secrecy laws because bank secrecy laws were an impediment to its efforts. FATF issued a report in 2000 designating 15 countries as uncooperative and threatened unspecified action if the countries did not change their laws and begin sharing financial information. Some countries have complied with the mandate, some remain, and others have been added. One action taken by FATF was to

advise U.S. financial institutions against a particular tax haven country as a significant money laundering threat, and transactions were to be scrutinized. This resulted in offshore banks losing U.S. correspondent relationships. The U.K. has taken similar action.

### **3.6 Organization for Economic Cooperation and Development**

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The Organization for Economic Cooperation and Development (OECD) came into force in 1961 and is based in Paris. It is composed of most all industrialized nations. It is also the parent to FATF. Since 1998, the OECD has promoted a global cooperative framework to offset harmful tax practices. Harmful tax practice is defined as one that meets one of four criteria: (1) there is no effective exchange of information; (2) there is a lack of transparency; (3) there are no substantial activities or ring fencing from domestic activities; and (4) there is an offering of low, nonexistent, or nominal tax rates. The OECD's aim is to establish effective exchange of information and transparency for tax purposes. The OECD's council recommended, *inter alia*, the following enforcement strategies against tax havens:

1. Removal of barriers of access to banking information by tax authorities
2. Greater and more efficient use of exchanges of information
3. Strengthening coordinated enforcement regimes
4. Increased assistance in recovery of tax claims
5. Strengthening of foreign information-reporting rules

The OECD identified some potential defensive measures to be utilized against tax havens in its July 31, 2001, report. Some possible defensive measures are:

1. To disallow deductions, exemptions, credits, or other allowances related to transactions with uncooperative tax havens
2. To require comprehensive information-reporting rules
3. To withhold taxes on certain payments to residents of uncooperative tax haven countries
4. To not enter into any comprehensive income tax conventions with uncooperative tax havens
5. To impose transactional charges or levies on certain transactions involving uncooperative tax haven countries

In 2000, the OECD focused its attack on the issues of bank secrecy and the exchange of information in tax investigations. It initially targeted 41 jurisdictions as tax havens and threatened economic sanctions unless the countries pledged to cooperate on tax matters, including the elimination of tax secrecy. At first, most nations stood firm, but one by one they began to fold. The tax haven countries have accused the OECD of tyranny and of infringing on their sovereignty. Tax haven countries fear the crackdown will hinder their efforts to develop new businesses. This is especially true for those tax haven countries whose economies are fragile, who have resource constraints or infrastructure limitations, or who are dependent upon financial services. The OECD's overreach must be seen in the context of an increasingly centralized Europe. Europeans are being guided into a

supranational European state with plans on central planning, homogenization of laws throughout the continent, heavy taxation, and inflation of the money supply. Even more, the United Nations is pushing for an international tax collection organization for global taxes and for an emigrant tax. In May 2001, the U.S. withdrew support for the OECD's initiative. The U.S. did not believe that any country or group of countries should interfere with another country's tax system. The U.S. did not support efforts to dictate to any country what its own tax rates or tax system should be and would not participate in any initiative to harmonize world tax systems. In June 2001, the OECD gave in to the U.S. demands and agreed to a less aggressive approach to combat tax evasion. The OECD agreed not to impose sanctions on tax havens that simply offer favorable tax breaks to foreign corporations and investors (ring fencing). The U.S. agreed to support its campaign to disclose account information of those suspected of tax evasion.

### 3.7 Fraud Indicators

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Fraud examiners will invariably come across offshore entities when examining organized crime elements with international connections. The fraud examiner should become familiar with the country of origin as well as the type of entity. An entity that is located in a tax haven country should be examined very closely. Indicators of fraudulent offshore entities are:

1. **No payments.** The offshore entity either lends or invests funds in the U.S. However, there are no interest or dividend payments going out.
2. **Not U.S. registered.** The offshore entity is not licensed to do business in the U.S. A check with the secretary of state, or bureau of corporations, of any particular state would show that the corporation or business entity is not registered or licensed to conduct business in the state. Failure for the foreign entity to register with the state bars any legal recourse or remedy. What company would loan or invest funds without having some legal recourse if the capital provided is not protected?
3. **Failure to file tax returns.** The offshore entity does not file federal or state tax returns. In general, income derived in the U.S. by foreign entities is taxable at both the federal and state level.
4. **No place of business.** The entity does not have any place of business in either the country of origin or the U.S. This will clearly show that the offshore entity is a means of concealing ownership of illegal funds.

Finance, investment, and insurance companies and trusts are the most common types of entities used to launder illegal gains from illegal activities through offshore companies.

### 3.8 Outlook for Tax Havens

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Tax haven countries have been a target of the industrialized world. Since 1998, the OECD nations have begun to target tax havens. Many tax havens are British protectorates. They are expected to comply with OECD dictates. For the remaining countries, OECD sanctions could destroy their tax haven businesses. The U.S. needs to be careful with tax havens in

the Caribbean, since their economies need to be preserved. If the economies were to collapse, the drug cartels would take over. Tax havens will survive, but in a different form. Tax havens will agree to information sharing with OECD countries, but only when there is an actual tax or criminal investigation. There will not be indiscriminate disclosure of identities and activities in using tax havens.

### **3.9 Summary**

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The fraud examiner should pay close attention to foreign individuals and entities that are located offshore. Attention is particularly necessary when foreign individuals and entities are located in tax haven countries that have bank secrecy laws or customs. Many tax haven countries have treaties whereby a prosecutor can obtain information. In some countries, records of legal entities are public and freely available. However, bank records are not available and will require some judicial proceeding to obtain them. Some of the tax haven countries cooperate with international law enforcement agencies, particularly in the drug trafficking area. Official requests can be made, but should go through the Department of State. The fraud examiner should study the country's legal system and find out what records are available and how to obtain them. Records that fall in the public domain can be obtained by a consular officer and certified by him or her for use in federal or state courts. Various federal law enforcement agencies, i.e., Customs, FBI, and the DEA, have liaison offices in many countries. These representatives can help obtain information for law enforcement. For instance, they can see if a foreign corporation has a business in the country of origin. They can secure public information and interview witnesses. For local law enforcement agencies, these resources should be utilized. All tax haven countries that allow bearer stock and bonds require that they be paid in full before they are issued. When these bearer stock and bonds are found in the course of searches, these securities have the same value as money. Depending upon the circumstances, these securities can be exchanged for cash.





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## 4.1 General

Forensic accountants must gather evidence to support an investigation of a financial crime that too often takes much time and effort to gather and compile. The objective of this chapter is to show the forensic accountant what evidence is admissible in both civil and criminal court proceedings. The Federal Rules of Evidence (FRE) are used in this chapter; therefore, forensic accountants should check with local prosecutors to ensure these rules are applicable to local courts.

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## 4.2 Evidence

Evidence is all means by which an alleged matter of fact is established or disproved. A forensic accountant can obtain documents and statements that show that a bank account has increased substantially. This is an evidentiary fact from which an inference may be drawn relative to the ultimate or principal fact, namely, that the subject was involved in a profitable activity. Evidence is legally admissible in court under the rules of evidence because it tends to support or prove a fact. Evidence is distinguished from proof in that the latter is the result or effect of evidence.

Direct evidence is that which proves the existence of the principal or ultimate fact without any inference or presumption. It is direct when those who have actual knowledge of them by means of their senses swear to the very facts in dispute. It may take the form of admissions or confessions made in or out of court.

Circumstantial evidence is that which tends to prove the existence of the principal fact by inference. The courts recognize the use of circumstantial evidence as a legitimate means of proof. It involves proving several material facts, which, when considered in their relationship to each other, tend to establish the existence of the principal or ultimate fact. Violations involving willful intent are provided by circumstantial evidence. It is the only type of evidence generally available to show such elements of a crime as malice, intent, or motive, which exists only in the mind of the perpetrator of the act. Circumstantial evidence may be as convincing as direct evidence. Sometimes, a jury may find that it outweighs conflicting direct evidence.

Evidence also may be classified as oral, documentary, and real. Evidence may be presented orally through witnesses or by the submission of records or other physical objects. Oral testimony consists of statements made by living witnesses under oath. Documentary evidence consists of writings such as judicial and official records, contracts, deeds, and less formal writings such as letters, memoranda, and books and records of private persons or organizations. Maps, diagrams, and photographs are classified as documentary evidence.

Real or physical evidence relates to tangible objects or property, such as a knife or pistol, that are admitted in court or inspected by a trier of facts. Evidence must be relevant, material, and competent in order to be admissible in court.

#### **4.2.1 Relevancy**

Relevancy relates evidence in some manner to the principal fact. It implies a traceable and significant connection. It is sufficient if it constitutes one link in a chain of evidence or if it relates to facts that would constitute circumstantial evidence that a fact in issue did or did not exist. Rule 401 defines relevant evidence as “evidence having any tendency to make the existence of any fact that is of consequence to the determination of the action more probable or less probable than it would be without the evidence.” Rule 402 provides that all relevant evidence is admissible, except as otherwise provided by the Constitution of the U.S., by acts of Congress, or by other rules prescribed by the Supreme Court pursuant to statutory authority. Evidence that is not relevant is not admissible.

Investigators should obtain all facts that relate to the case. They should never omit any significant facts because of doubt regarding relevance. There are no set standards for relevancy because facts vary from case to case and judges have wide discretion in determining what evidence is relevant. Also, investigators should not omit evidence because of doubt as to its materiality or competency.

#### **4.2.2 Materiality**

Evidence is material if it is essential to the subject matter in dispute as to affect the outcome of a trial, or to help establish the guilt or innocence of the accused. This definition is included in the definition of relevancy.

#### **4.2.3 Competency**

Evidence must not only be relevant and persuasive but also legally admissible. Relevant evidence may be incompetent and hence inadmissible because it is hearsay or not the best evidence. Evidence, such as documents, is competent if it was obtained in a manner and from a source proper under the law.

### **4.3 Limited Admissibility**

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Evidence may not be admissible for one purpose but does not preclude its use for another. A piece of evidence may not be admissible as independent proof of a principal fact and still may be admitted to corroborate another fact.

## 4.4 Hearsay

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Hearsay has been defined as evidence that does not come from the personal knowledge of the witness but from what he has heard others say or documents prepared by others. Hearsay is secondhand evidence and is not admissible in court. An investigator's testimony that corporate checks to payees were for personal expenses of the subject, an officer of the corporation, is inadmissible as hearsay (Greenberg rule). The personal nature of the payments should be proven through the subject's own records or others' as to his admission, or the testimony of third parties.

Cross-examination is essential as a test of the truth of the facts offered. It provides an opportunity to test the credibility of the witness, his observations, memory, bias, prejudice, and possible errors. It subjects the witness to the penalties of perjury and may eliminate deliberate or unintentional misstatements of what he has been told.

## 4.5 Admissions and Confessions

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An admission is not considered to be hearsay. An admission may be defined as a statement or act of a party that is offered in evidence against him. It also may be defined as a prior oral or written statement or act that is inconsistent with his position in the pleadings or at trial. Admissions can be used either as evidence of facts or to discredit a party as a witness. They can be used only as to facts, not as to matters of law, opinion, or hearsay. A confession is a statement of a person that he is guilty of a crime.

## 4.6 Exceptions to Hearsay Rule

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The courts have made certain exceptions to the hearsay rule. These are based on two principal reasons: necessity for use and probability of trustworthiness. The necessity rule usually comes into being from the unavailability of the person who made the statement to appear or testify, and the court would thereby be deprived of evidence that is important in the decision of an issue. The evidence must also have the probability of truthfulness that will substitute for cross-examination. Evidence that meets the above standards is admissible as an exception to the hearsay rule. Other exceptions are as follows.

### 4.6.1 Business Records, Public Records, and Commercial Documents

Records containing entries made in the regular course of business, as well as marriage, baptismal, and similar certificates, are admissible without testimony of the person who made the entries, if some witness properly identifies them. Public records made by an officer in the performance of his duties are also admissible after proper authentication.

### 4.6.2 Expert and Opinion Testimony

Expert opinions are the conclusions of persons who have been qualified as experts in their respective fields; they are admitted to aid the jury in its deliberations. Opinions of laymen may also be admitted into evidence under certain circumstances, e.g., handwriting recognition and physical condition. As another example, a police officer may give his opinion



concerning the speed of an automobile. The basis for permitting this is that the police officer has specialized experience beyond that of the ordinary person, which would qualify him to give his opinion in the matter.

### **4.6.3 Reputation**

A defendant in a prosecution may offer witnesses to testify as to his good reputation in the community where he lives. Such evidence is competent because it may tend to generate a reasonable doubt of his guilt. The evidence should be restricted to the character trait in issue and should bear an analogy to the nature of the charge. For instance, asking a witness for the defendant in a bribery case, on direct examination, if he knows the defendant's general reputation for peacefulness would be improper. The witnesses must confine their testimonies to general reputation and may not testify about their own knowledge or observation of the defendant, or about his specific acts or courses of conduct. Once the defense has raised the issue of character, the prosecution may offer evidence of bad reputation in rebuttal to character testimony. Rule 405 provides that "on cross-examination inquiry is allowable into relevant specific instances of conduct."

### **4.6.4 Records of Documents Affecting an Interest in Property**

If a document affecting an interest in property, e.g., a deed, is recorded in a public record and an applicable statute authorizes the recording of documents of that kind in that office, the record of such document may be admissible as proof of the original recorded document and its execution and delivery by each person by whom it purports to have been executed (FRE 803(114)).

### **4.6.5 Mental and Physical Condition**

Contemporaneous or spontaneous declarations of a person may be admissible to prove his mental or physical condition. While such statements carry more weight when made to a physician for purposes of treatment, they may be competent even if made to family members or other persons. Thus, a trial court in a fraud case might admit a lay witness's testimony that he heard the defendant complain of severe headaches and inability to concentrate just before preparing his alleged false travel expense voucher.

### **4.6.6 Excited Utterance**

Also known as a spontaneous declaration, an excited utterance has been defined as a "statement relating to a startling event or condition made while the declarant was under the stress or excitement caused by the event or condition" (Rule 803.2). The trustworthiness of such statements lies in their spontaneity, for the occurrence must be startling enough to produce a spontaneous and unreflected utterance without time to contrive or misrepresent.

Excited utterances may be made by participants or bystanders, and a person who made or heard such statements may testify about them in court.

#### **4.6.7 Recorded Recollection**

A memorandum or record about which a witness once had knowledge, but at the time he is called to testify has insufficient recollection to enable him to testify fully and accurately, may be used in court. It must be shown, however, that the memorandum or record was made or adopted by the witness when the matter was fresh in his memory and reflects his knowledge correctly. If admitted, the memorandum or record may be read into evidence, but it may not itself be received as an exhibit unless offered by an adverse party (Rule 303.5).

#### **4.6.8 Absence of Entry**

The FRE also provides for an exception to the hearsay rule with respect to evidence of the absence of an entry in records kept in the regular course of business, and absence of a public record or entry if the matter was of a kind in which the business or public office ordinarily made and preserved a record. It must be shown that a diligent search of the records has been made, and the evidence may be ruled inadmissible if “the sources of the information or other circumstances indicate of trustworthiness” (Rules 308.7 and 308.10).

### **4.7 Hearsay Exceptions: Declarant Unavailable**

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The following exceptions to the hearsay rule relate to situations in which the declarant (person who made the statements) is unavailable for the trial (for example, if he has died, has disappeared, is mentally or physically incapacitated, is beyond the jurisdiction of the court, or is exempted by ruling of the court on the grounds of privilege concerning the subject matter of his statement).

#### **4.7.1 Former Testimony**

This is testimony given by a witness at another hearing of the same or a different proceeding, or in a deposition taken in compliance with the law in the course of the same or another proceeding, if the party against whom the testimony is now offered (in a criminal proceeding) had an opportunity and similar motive to develop the testimony by direct, cross-, or redirect examination (Rule 804(b)(1)). Testimony and evidence in civil proceedings can be used later on in criminal proceedings.

#### **4.7.2 Statement against Interest**

A statement against interest relates to an oral or written declaration by one not a party to the action and not available to testify. It must be shown that such statement was, at the time of its making, so far contrary to the declarant’s pecuniary or proprietary interest or so far tended to make invalid a claim by him against another, that a reasonable person in his position would not have made the statement unless he believed it to be true. For example, in order to establish that a defendant paid off a large debt with currency on a certain date, the government may prove the payment through an entry in the personal diary of the deceased creditor. The diary could be identified by a relative of the deceased as having been found among his papers after his death (Rule 804(b)(3)). Some courts have extended this rule to include statements against penal interest.

### 4.7.3 Dying Declarations

Dying declarations are statements made by the victim of a homicide who believes that death is imminent. To be admissible, such statements must relate only to facts concerning the cause for and circumstances surrounding the homicide charged. They are admitted from the necessities of the case to prevent a failure of justice. Furthermore, the sense of impending death is presumed to remove all temptation of falsehood. The statements may be admitted only in a murder trial or, under Rule 804(b)(2), in a civil proceeding.

## 4.8 Documentary Evidence

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Documentary evidence is evidence consisting of writing and documents, as distinguished from oral evidence.

### 4.8.1 Best Evidence Rule

The best evidence rule, which applies only to documentary evidence, is that the best proof of the contents of a document is the document itself. The best evidence rule, requiring production of the original document, is confined to cases where it is sought to prove the contents of the document. Production consists of making the writing available to either the court or opposing counsel. Facts about a document other than its contents are provable without its production. For example, the fact that a sales contract was made is a fact separate from the actual terms of the contract and may be proven by testimony alone.

The best evidence rule has applied essentially to documents. Modern techniques of storing data have made its expansion to include computers, photographic systems, and other new developments. In Rule 1001 writings and recordings are defined as “letters, words or numbers, or their equivalent, set down by handwriting, typewriting, printing, photostating, photographing, magnetic impulse, mechanical or electronic recording, or other form of data compilation.” The original of a writing or recording is defined as “the writing or recording itself or any counterpart intended to have the same effect by a person executing or issuing it.”

Certain documents, such as leases, contracts, or even letters, which are executed “signed” in more than one copy are all considered originals, and any one of the copies may be produced as an original.

#### 4.8.1.1 Application of Best Evidence Rule

When an original document is not produced and its absence is satisfactorily explained, secondary evidence, which could consist of testimony of witnesses or a copy of writing, will be received to prove its contents. Unavailability of the original document is a question to be decided by the trial judge, just as he decides all questions regarding admissibility of evidence.

The reason for the rule is to prevent fraud, mistake, or error. For example, the testimony of an investigator as to the contents of a sales invoice will be excluded unless it is shown that the invoice itself is unavailable. If the document is unavailable, the investigator’s testimony is admissible, even though the person who prepared the invoice is available to testify. The best evidence rule will not be invoked to exclude oral testimony of one witness merely because another witness could give more conclusive testimony.

## 4.9 Secondary Evidence

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All evidence that does not meet the best evidence rule is classified as secondary evidence and is a substitute for better evidence. Secondary evidence may be either the testimony of a witness or a copy of a document. There is no settled rule for which of these is a higher degree of secondary evidence. Secondary evidence of any nature may be admitted in court. There must be evidence of the present or former existence of an original document, and it must be established that the original has been destroyed — destruction provable by an eyewitness. The party proving the document must have used all reasonable means to obtain the original; that is, he must have made such diligent search as was reasonable under the facts. Some cases have specifically set the rule that search must be made in the place where the document was last known to be, or that inquiry must be made of the person who last had custody of it. In every case, the sufficiency of the search is a matter to be determined by the court. If a document is offered as secondary evidence, it must be shown to be a correct copy of the original to be admissible.

When the original document has been destroyed by the party attempting to prove its contents, secondary evidence of the contents will be admitted if the destruction was in the ordinary course of business, or by mistake or even intentionally, provided it was not done for any fraudulent purpose.

With respect to an original document in the possession of an opponent, Rule 1004 provides that the original is not required and that other evidence of the contents is admissible if at the time the original was under the control of the party against whom it was offered, he was put on notice by the pleadings or otherwise that the contents would be subject to proof at the hearing and he does not produce the original at the hearing.

### 4.9.1 Admissibility of Specific Forms of Documentary Evidence

This includes records of regularly conducted (business) activity. Rule 803(6) states:

A memorandum, report, record, or data compilation, in any form, of acts, events, conditions, opinions, or diagnoses, made at or near the time by, or from information transmitted by, a person with knowledge, if kept in the course of regularly conducted business activity, and if it was the regular practice of that business activity to make the memorandum, report, record, or data compilation, all as shown by the testimony of the custodian or other qualified witness, unless the source of information or the method or circumstances of preparation indicate lack of trustworthiness, is admissible.

The term *business* as used in this paragraph includes business, institution, association, profession, occupation, and call of every kind, whether or not conducted for profit.

The above rule permits showing that an entry was made in a book maintained in the regular course of business without producing the particular person who made the entry and having him identify it. For example, in proving a sale, an employee of the customer may appear with the original purchase journal and cash disbursement book of the customer and testify that these were books of original entry showing purchases by the customer, even though the witness is not the person who made the entries.

### 4.9.2 Regular Course of Business

This rule relies on records made under circumstances showing no reason or motive to misrepresent the facts. As stated by the courts, the rule contemplates that certain events are regularly recorded as “routine reflections of the day to day operations of the business so that the character of the records and their earmarks of reliability import trustworthiness.” For example, the rule is applied to bank records under the theory that the accuracy of the records is essential to the very life of the bank’s business.

The fact that a record has been kept in the regular course of business is not enough to make it admissible. The rules of competency and relevancy must still be applied. If a ledger is offered in evidence to prove entries posted from a journal, which is available, the journal itself, as the book of original entry, should be produced.

If it is the practice to photograph, photostat, or microfilm the business records mentioned above, such reproductions, when satisfactorily identified, are as admissible as the original. Also, enlargements of the original reproductions are admissible if the original reproduction is in existence and available for inspection under the direction of the court. This rule is particularly helpful in connection with bank records because of the common practice of microfilming ledger sheets, deposit tickets, and checks.

### 4.9.3 Photographs, Photostats, and Microfilmed Copies

Photographs, photostats, and microfilmed copies of writings not made in the regular course of business are considered secondary evidence of the contents, generally inadmissible if the original can be produced and no reason is given for failure to produce it. The same rule is usually applied where the original is already in evidence and no reason has been given for offering the copy. However, notes of the advisory committee regarding the Federal Rules of Evidence indicate an intent to liberalize the rule with respect to photostat copies to the extent that such copies may be admitted in evidence in the absence of a showing of some reason for requiring the original (Rule 1003).

A photographic or photostat reproduction of a document may be admitted after evidence has been produced that the original cannot be obtained and that the reproduction is an exact and accurate copy. This principle has been followed where the original was in the hands of the defendant and the government could compel its production. It has further been held that a photograph of a promissory note taken because the writing was becoming faded and illegible is admissible in place of the illegible original.

When photostats of documents are obtained during an investigation, they should be initialed on the back, after comparison with the original, by the one who made the photostat or by the investigator who obtained the document that was photostatted. The date of such comparison should be noted following the initials. The source of the original document should be set out on the reverse of the photostat or on an initialed attachment or memorandum relating to each photostat or group of photostats covered by the one memorandum. This procedure will ensure proper authentication at a trial.

### 4.9.4 Transcripts

Transcripts are copies of writings. They are admissible as secondary evidence. The investigator should ensure proper authentication for their admission in court when the original documents are not available. The investigator should compare the transcript with the

original and certify it. The certification should show the date of transcripts, by whom, where, and the source. Each page should be identified to show that it forms part of the whole or is a partial item.

#### **4.9.5 Charts, Schedules, and Summaries**

Charts, schedules, and summaries prepared by summary or expert witness can be placed in evidence if they are summaries of evidence previously admitted in court. Charts, summaries, and schedules have been permitted in the jury room to aid in the jury's deliberations. Schedules may be used to summarize specific business transactions, e.g., the accumulated cost of a construction project, after the introduction of the pertinent records and testimony. Prejudicial headings or titles should be avoided, e.g., false claims.

#### **4.9.6 Notes, Diaries, Workpapers, and Memoranda**

Notes, diaries, workpapers, and memoranda made by auditors and accountants are not considered evidence. Auditors and accountants can use them on the witness stand or prior to testifying as an aid to recollection, or they may be introduced into evidence by the adverse party if they constitute impeaching evidence. Any documents used by a witness are subject to inspection by opposing counsel.

#### **4.9.7 Proving Specific Transactions**

It is not sufficient to rely on documents and recorded entries. Documents and recorded entries are not facts but written descriptions of the event. Witnesses will have to testify about the transaction and authenticate the documents. This is called the Greenberg rule. The investigator must interview the party of the transaction to ensure the documents or entries substantiate the circumstances. The witness may have additional facts or documents relating to the transaction or other transactions. Vendors should be questioned as to all transactions and any other information. Sellers and agents should be questioned as to the details of the transactions for possible nominees and nonexistent parties. Complete documentation and witness interviews should be obtained for each and every transaction as much as possible.

#### **4.9.8 Official Records**

The provisions of the Federal Rules of Evidence and rules of criminal and civil procedure cover the admissibility of official public records and copies or transcripts thereof in federal proceedings.

##### ***4.9.8.1 Authentication of Official Records***

Evidence must be authenticated in order to establish its reliability. It must be shown that a certain document actually is an official record of a particular state or local government. Document authenticity does not mean it will be admissible in court.

##### ***4.9.8.2 Admissibility of Official Records***

The admissibility of official records and copies is provided by the Federal Rules of Evidence. Rule 1005 states:

The contents of an official record, or of a document authorized to be recorded or filed and actually recorded or filed, including data compilations in any form, if otherwise admissible, may be proven by copy, certified as correct in accordance with Rule 902 or testified to be correct by a witness who has compared it with the original.

If a copy that complies with the foregoing cannot be obtained by the exercise of reasonable diligence, then other evidence of the contents may be given. Under this rule, there is no requirement that the original be introduced.

Rule 902 provides that extrinsic evidence of authenticity is not required for certain types of documents, including public documents under seal, certified copies of public records, newspapers and periodicals, trade inscriptions and the like, labels purporting to have been affixed in the course of business and indicating ownership and control or origin, and commercial papers and related documents to the extent provided by general commercial law. This does not mean that the documents will be admitted.

A method of authentication of copies of federal records is set forth in the Federal Rules of Civil Procedure, which is made applicable to criminal cases by Rule 27 of Federal Rules of Criminal Procedure. Authentication of a copy of a government record under these rules would consist of a certification by the officer having custody of the records and verification of the official status of the certifying officer by a federal district judge over the seal of the court.

#### **4.9.9 State and Territorial Statutes and Proceedings**

The admissibility of copies of legislative acts of any state, territory, or possession of the U.S. and of court records and judicial proceedings is provided for in Title 28 of the U.S. Code, Section 1738 (28 USC 1738), as follows:

Such acts, records and judicial proceedings or copies thereof, so authenticated, shall have the same full faith and credit in every court within the United States and its territories and possessions as they have by law or usage in the courts of such state, territory or possession from which they are taken.

The procedures for authentication of the above records are recited in the same section of the code.

Nonjudicial records or books kept in any public office of any state, territory, or possession of the U.S., or copies thereof, are made admissible by the U.S. Code and given full faith and credit upon proper authentication (28 USC 1739). Rules 901 and 902 provide procedures for authentication of the documents covered in this section.

#### **4.9.10 Chain of Custody**

*Chain of custody* is an expression that is applied to consecutive custodians of the physical items or documents in their original condition. Documents or other items used in a crime are generally admissible in court. The judge must be satisfied that the writing or other items are in the same condition as they were when the crime was committed. The witnesses through whom the documents or other items are sought to be introduced must be able to identify them as being in the same condition as when they were recovered. Investigators

must identify and preserve in original condition all evidentiary matter that may be offered into evidence.

#### **4.9.11 Identification of Seized Documentary Evidence**

In order that a seized document be admissible as evidence, it is necessary to prove that it is the document that was seized and that it is in the same condition as it was when seized. Since several persons may handle it in the interval between the seizure and the trial of the case, it should be adequately marked at the time of seizure for later identification, and its custody must be shown from that time until it is introduced in court.

An investigator who seizes documents should at once identify them by some markings so that he can later testify that they are the documents seized and that they are in the same condition as they were when seized. The investigator should put his initials and the date of seizure on the back of each document or put the document into an envelope and write a description and any other identifying information on the face of the envelope and seal the envelope.

### **4.10 Constitutional Provisions**

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The principal constitutional limitations relating to investigative techniques are the Fourth, Fifth, and Sixth Amendments to the U.S. Constitution and similar provisions in the state constitutions.

#### **4.10.1 The Fourth Amendment**

The Fourth Amendment provides:

The right of the people to be secure in their persons, houses, papers and effects, against unreasonable searches and seizures, shall not be violated, and no warrants shall issue, but upon probable cause, supported by oath or affirmation, and particularly describing the place to be searched and the persons or things to be seized.

This protection is given to corporations as well as individuals.

#### **4.10.2 The Fifth Amendment**

The relevant part of the U.S. Constitution's Fifth Amendment provides: "No person shall be compelled in any criminal case to be a witness against himself, nor shall he be deprived of life, liberty, or property without due process of law."

This privilege is given only to individuals, not to corporations.

#### **4.10.3 The Sixth Amendment**

The relevant part of the U.S. Constitution's Sixth Amendment states: "In all criminal prosecutions the accused shall enjoy the right to have the assistance of counsel for his defense."



## 4.11 Statutory Provisions

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Statutes can be passed permitting financial investigations if they are within constitutional guidelines. Challenges to financial investigations have been litigated primarily in federal courts, particularly tax-related cases. Therefore, federal court decisions are based on the federal Constitution and statutes, most of which deal with tax cases.

### 4.11.1 Court Decisions

U.S. Supreme Court decisions are based on the U.S. Constitution and are binding on state courts and officers. Federal court decisions relating to federal statutes are not directly binding on state officers, since they operate under state statutes. But state statutes must conform to federal statutes either directly or indirectly, so the rulings on similar provisions are quite relevant on how the state courts can interpret its statutes.

### 4.11.2 Access to Books and Records

Federal and many state statutes provide that certain auditors can examine a subject's books and records and summon subjects (including third-party witnesses) to come before them to give testimony or bring records. The Fourth Amendment prohibits illegal search except for probable cause. The Fifth Amendment prohibits self-incrimination. If the federal and state auditors request these records in the normal course of their business, then this does not violate the Fourth or Fifth Amendment. If the subject voluntarily submits to the auditor's request, then this is not a violation of his Fourth or Fifth Amendment rights. However, if the auditor requests these records for a criminal investigator without the suspect's knowledge, then this is a violation of the suspect's Fourth Amendment rights (*United States v. Nicholas J. Tweel*, 550 F2d 297).

Some courts and state statutes permit certain regulatory searches to be made without warrants, but these regulatory searches cannot be used in criminal cases.

### 4.11.3 Privileged Relationships

The rule on privileged communications is based on common law and the legislature's belief that it is necessary to maintain the confidentiality of certain communications. It applies only to those communications that relate to a unique relationship. They must have been made in confidence and not in the presence of third parties, unless the speaker has a privileged relationship with the third party. Common law has granted the privilege to the following relationships:

1. Husband–wife
2. Attorney–client
3. Ordained clergyman–parishioner
4. Physician–patient
5. Reporter–source
6. Accountant–client (not recognized in federal courts)

Only the holder of a privilege or someone authorized by him can assert a privilege. The privilege can be waived if he fails to assert it, after having notice and an opportunity

to assert it. He also waives it if he discloses a significant part of the communication or if the communication is made in front of a third party whose presence is not indispensable to the conversation. The presence of a secretary or an interpreter would not abolish the privilege.

The client holds the attorney–client privilege, not the lawyer, and the privilege does not terminate at the client’s death. The communication is protected only if its purpose was related to legal consultation. An exception is where the attorney was consulted for the purpose of aiding in the perpetration of a crime or fraud or for the giving of business advice.

## **4.12 Foreign Evidence**

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Evidence from foreign countries is admissible in federal courts. Some criminal elements operate on an international level. Therefore, it is important that foreign countries, when known, be asked for assistance and cooperation. In most cases, foreign governments will cooperate and give assistance as necessary. The U.S. has many mutual assistance, extradition, and tax treaties. As a general rule, only high-tax countries have tax treaties with other high-tax countries. Tax haven countries will not provide financial information in criminal or civil tax cases. Some tax haven countries will provide financial information in nontax criminal cases. However, the requesting country must certify that the evidence provided will not be used for tax purposes.

### **4.12.1 Foreign Public Documents**

Foreign public documents are admissible in federal courts when properly attested and certified. Also, a secretary of an embassy or legation, consul general, consul, or consular agent of the U.S. may make a final certification. If reasonable opportunity has been given to all parties to investigate the authenticity and accuracy of official documents, the court may, for good cause shown, order that they be treated as presumptively authentic without final certification or permit them to be evidenced by an attested summary with or without final certification. Foreign public records are the most easily obtained since public access is readily obtained.

### **4.12.2 Foreign Documents**

18 USC 3491 provides that any book, paper, statement, writing, or other document, or any portion thereof, of whatever character and in whatever form, as well as any copy thereof equal with the original, that is not in the U.S. shall, when certified, be admissible in evidence in any criminal action or proceeding in any court of the U.S. This clearly shows that foreign documents, when properly certified, are admissible in criminal cases.

#### **4.12.2.1 Consular Officers’ Commission**

U.S. consular officers are responsible for taking oral or written interrogatories of witnesses in foreign countries. They are also tasked with the authority of authenticating foreign documents that will be used in any criminal proceeding. The court shall make provisions for the selection of foreign counsel to represent each party to the criminal action. Selection of foreign counsel shall be made within 10 days of taking testimony. Foreign counsel does not represent the U.S. If the consular officer has an interest in the outcome of the criminal

action or proceeding, or has participated in the investigation or preparation of evidence, then the consular officer is disqualified from taking oral or written interrogatories (18 USC 3492).

#### **4.12.2.2 Deposition on Foreign Documents**

18 USC 3493 provides that the consular officer shall caution and swear in testimony as to the whole truth. The witness testimony shall be reduced to writing by the consular officer or by some person under his personal supervision. Every foreign document shall be annexed to such testimony and subscribed by each witness for the purpose of establishing the genuineness of such document. The consular officer shall obtain an interpreter if needed.

#### **4.12.2.3 Foreign Records**

The rules for admission of foreign documents are about the same as for domestic documents. Foreign records of regularly conducted activity, or copies of such records, shall be admissible as evidence provided that such documents are authenticated as genuine.

#### **4.12.2.4 Foreign Witnesses**

If a person is held in custody in a foreign country that is needed in the U.S. in a criminal proceeding, the attorney general shall request the foreign country to temporarily transfer that person to the U.S. for the purpose of giving testimony. The person shall be returned to the foreign country when the task is finished. If a treaty or convention is in effect with the foreign country, then the terms of the treaty or convention shall be adhered to.

### **4.13 Awareness**

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The forensic accountant should always be aware of the rules of evidence. Evidence obtained improperly is inadmissible and thus becomes worthless. The following checklist should help in verifying compliance with the rules of evidence.

1. **Chain of custody.** Is a log maintained of evidence obtained and who has had access to the evidence?
2. **Witnesses.** Are interview memoranda, depositions, etc., maintained for each witness? Also, are name, addresses, and contact telephone numbers maintained for each witness?
3. **Physical evidence.** Is physical evidence properly secured? Only copies of documents should be used for marking, not originals.
4. **Diary.** The fraud examiner should maintain a diary showing dates of interviews, when and where evidence was obtained, and a description of work performed.
5. **Notes.** All interview notes should be kept and not destroyed.
6. **Expenses.** All expenses should be documented. If informants are paid, then some type of receipt should be obtained. Informants can initial a diary entry or appointment book.

In Chapter 14, on accounting and auditing techniques, there is a recommended witness list that can be maintained on a computer database. This witness list will help the forensic

accountant keep track of witnesses and evidence. It can also help the prosecutor in the planning and scheduling of witnesses for trial.

#### **4.14 Summary**

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Both fraud examiners and law enforcement must have some knowledge of the rules that allow evidence into court. No prosecutor wants evidence that is not admissible. If inadmissible evidence is entered into court, then the defendant has grounds on appeal to get his conviction thrown out. The Supreme Court, under its exclusionary rule, will overturn convictions when inadmissible evidence is introduced in court. Evidence must be properly guarded and handled. Any defacing or alteration of evidence will make the evidence inadmissible. Evidence can only be obtained in a legal manner. Security procedures should be set up and followed in order to preserve evidence. Without evidence, there is no case. Evidence from any part of the world is admissible, provided that it is obtained in a proper and legal manner.



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# Net Worth Theory

# 5



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## 5.1 General

The Internal Revenue Service was the first to use the net worth method. According to Section 61, Internal Revenue Code, all taxpayers are to report all taxable income. For taxpayers who do not report all their taxable income, the Internal Revenue Service devised the net worth method to determine the amount of unreported taxable income. The Internal Revenue Service acknowledges that this method is appropriate in cases where the taxpayer accumulates vast amounts of assets. It is not useful in cases where the taxpayer has little or no assets and spends all his income on lavish living. When Congress passed the Racketeer Influenced and Corrupt Organization (RICO) act in 1970, it expanded the use of the net worth method to organized crime.

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## 5.2 Tax Use

The net worth method is preferred by the Justice Department and was used as far back as 1931 on Alfonso Capone (2 U.S. Tax Code (USTC) 786) by the Internal Revenue Service. The net worth method is not an accounting method, but a method of proof by circumstantial or indirect evidence. The IRS attempts to establish an “opening net worth,” which is defined as assets less liability. It then proves increases in the taxpayer’s net worth for each succeeding year during the period under examination. The taxpayer’s nondeductible personal expenditures less nontaxable income are added to each year’s increase in net worth. This is compared to income reported, and any differences are considered to be unreported income. Table 5.1 is presented to illustrate the theory.

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## 5.3 RICO Use

The above theory relates to tax purposes. The use of RICO and other economic crime cases requires a different set of principles and a different presentation. The basic theory in RICO net worth is similar to the tax method. The basic objective is different. In RICO net worth, the objective is to determine the amount of illegal income. Like the tax purpose net worth method, RICO net worth is defined as assets less liabilities. It proves increases

**Table 5.1 Tax Net Worth Theory**

Year One	Year Two
Assets	Assets
Less: Liabilities	Less: Liabilities
Equals: Net Worth	Equals: Net Worth
	Less: Net Worth Year One
	Equals: Net Worth Increase
	Add: Nondeductible Expenditures
	Less: Nontaxable Income
	Equals: Corrected Taxable Income
	Less: Reported Taxable Income
	Equals: Unreported Taxable Income

**Table 5.2 RICO Net Worth Theory**

Year One	Year Two
Assets	Assets
Less: Liabilities	Less: Liabilities
Equals: Net Worth	Equals: Net Worth
	Less: Net Worth Year One
	Equals: Net Worth Increase
	Add: Personal Expenses
	Equals: Legal Income
	Less: Legal Income
	Equals: Illegal Income

in net worth for each succeeding year. The subject's personal expenditures are added to each succeeding year's increase in net worth. This gives the gross income. The legal income is subtracted to determine the amount of illegal income derived. Table 5.2 illustrates the theory.

## 5.4 History

The first net worth case was *Alfonso Capone v. United States* (2 USTC 786). The U.S. Supreme Court heard the first net worth case in 1943 with *United States v. Johnson* (43-1 USTC 9470). In the Johnson case, the Supreme Court approved its use as a potent weapon in establishing taxable income from undisclosed sources when all other efforts failed. Since then, the net worth has been widened; it is now used in run-of-the-mill cases, regardless of the tax deficiency involved. The Supreme Court has denied *certiorari* because the cases involved were only questions of evidence and presented no important questions of law. The Court of Appeals had serious doubts regarding the implications of the net worth method. In 1954, the Supreme Court granted *certiorari* in four cases. One of these was *M.L. Holland v. United States* (54-2 USTC 9714); the High Court pointed out the dangers that must be kept in mind in order to ensure adequate appraisal of facts in individual cases. These dangers include:

1. **Cash hoard.** A favorite defense is the existence of substantial cash on hand. The defense is that the cash is made up of many years of savings, which for various reasons were hidden and not expended until the prosecution period. Obviously, the government has great difficulty in refuting such a contention. However, this can be overcome when the emergence of hidden savings also uncovers a fraud on the taxpayer's creditors. Also, taxpayers frequently give lead to agents, indicating

- specific sources of cash on hand. This forces the government to run down all such leads in face of grave investigative difficulties; still, a failure to do so might jeopardize the position of the taxpayer.
2. **Assumptions.** The method requires assumptions, among which is the equation of unexplained increases in net worth with unreported taxable income. It may be that those gifts, inheritances, loans, and the like account for newly acquired wealth. Base figures have a way of acquiring an existence of their own independent of the evidence that gave rise to them. Therefore, the jury needs the appropriate guarding instructions.
  3. **Poor memory or business judgment.** The taxpayer may be honest yet is unable to recount his financial history. The net worth method could tend to shift the burden of proof from the government to the taxpayer. The taxpayer would then be compelled to come forward with evidence, which could lend support to the government by showing loose business methods or apparent evasiveness.
  4. **Books and Records.** When the government uses the net worth method, and the books and records of the taxpayer appear correct on their face, an inference of willful tax evasion could be inferred that might be unjustified, where the circumstances surrounding the deficiency are as consistent with innocent mistake as with willful violation. On the other hand, the very failure of the books to disclose a proven deficiency might include deliberate falsification.
  5. **Taxpayer statements.** The prosecution, in many cases, relies on the taxpayer's statements made to revenue agents in the course of their investigation. When revenue agents confront the taxpayer with an apparent deficiency, the revenue agent may be more concerned with a quick settlement than an honest search for the truth. The prosecution may pick and choose from the taxpayer's statements, relying on the favorable portion and throwing aside that which does not bolster the taxpayer's position. An investigator must obtain not only inculpatory evidence, but also exculpatory evidence.
  6. **Time periods.** The statute defines the offenses by individual years. While the government may be able to prove with reasonable accuracy an increase in net worth over a period of years, it often has great difficulty in relating that income sufficiently to any specific prosecution year. Unless the increase can be reasonably allocated to the appropriate tax year, the taxpayer may be convicted on counts of which he is innocent.

The Supreme Court also added that the trial courts should approach these cases in full realization that the taxpayer may be ensnared in a system that is hard for the defendant to refute. Charges should be especially clear and formal in instructions as to the nature of the net worth method, the assumptions on which it rests, and the inferences available to both sides.

The main thrust of the net worth method since the Holland case is that the method can be used against the ordinary average citizen without criminal affiliations. It may also be used to show that the taxpayer's books do not reflect true income or to corroborate specific adjustments in the agent's report. For the revenue agents, they must make an effort to seek the truth rather than try to get a quick settlement to close out the case.



Since the Holland case, there have been many court decisions that affect either the net worth presentation or the source of such item on the net worth. Some of the court decisions should be kept in mind when preparing a net worth statement. They are:

1. **Burden of proof.** In *Jacobs v. United States* (54-1 USTC 9704), the burden of proof rests with the taxpayer in rebutting a net worth method, especially when he does not keep required books and records.
2. **Cash on hand.** In the *W. Epstein* (57-2 USTC 9797) case, the government used cash-on-hand figures that came from financial statements submitted by the taxpayer to his bank and reports to Dun and Bradstreet. On the other hand, the courts have ruled that the Internal Revenue Service may not determine that the taxpayer had no cash on hand at the beginning of a specified period merely because the taxpayer made no affirmative showing to the contrary (Thomas, 56-1 USTC 9449; L. Fuller, 63-1 USTC 9248).
3. **Family group.** In the *William G. Lias* (56-2 USTC 9817) case, the court approved the consolidated net worth of family members, where the taxpayer had no permanent books and refused to furnish financial statements. From the combined taxable income, agents deducted income reported or adjusted for the other members of the family group and treated the balance as taxable income of the taxpayer.
4. **Cost of living.** In the *H.G. Leach* (36 TCM 998) case, the court allowed the use of cost-of-living data supplied by the Bureau of Labor Statistics, but adjustments were made to reflect the size of the taxpayer's family and their geographical location. This is a civil case; it cannot be used in a criminal case. It can be inferred that these data can be used in civil RICO cases as well. So far, this has not been tried.
5. **Corroboration.** In *Daniel Smith v. United States* (54-2 USTC 9715), the court determined that the government, in a criminal case, must corroborate a defendant's opening statement of net worth. The use of the taxpayer's tax returns showing poor financial history prior to the prosecution period is corroboration of the defendant's opening net worth. However, in *Greenberg v. United States* (61-2 USTC 9727), a criminal case, the agent prepared a check spread and made the assumption that all expenditures were personal in nature. Further, no records or admissions of the defendant corroborated the agent's testimony, nor did any payee or other third party testify. This case pointed out that the use of check spreads or third parties, and not the agent's conclusions or assumptions, must corroborate any method used.
6. **RICO use.** Congress, since the Holland case, has enacted new laws and amended others in order to fight organized crime and drug kingpins. The Comprehensive Crime Control Act of 1984 and the Anti-Drug Abuse Act of 1986 have now forced the net worth method to be used in nontax cases. In civil cases, the net worth method is used to identify assets for seizure and forfeiture. In criminal cases, the net worth method is used to show the amount of financial benefit derived from some illegal activity. Under 18 USC 371, the prosecution can obtain a conviction under the conspiracy section to defraud the U.S. government. In *Klein v. United States* (355 US 924), the conspiracy to defraud the U.S. by impeding, impairing, obstructing, and defeating the lawful functions of the Department of the Treasury in the collection of taxes was upheld. No proof of financial loss to the government was necessary.

U.S. attorneys, as well as state attorneys whose states have adopted or copied U.S. Title 18 laws, have been obligated to rely on the net worth method in proving both their civil and criminal cases. 18 USC 1963(a)(b), Racketeering Influenced Corrupt Organizations, provides the following:

In lieu of a fine otherwise authorized by this section, a defendant who derives profits or other proceeds from an offense may be fined not more than twice the gross profits or other proceeds.

(b) Property subject to criminal forfeiture under this section includes:

- (1) Real property including things growing on, affixed to, and found in land; and
- (2) Tangible and intangible personal property, including rights, privileges, interests, claims, and securities.

The net worth method provides prosecutors the precise means of determining the illegal gains and, at the same time, identifying the assets and expenditures. For prosecutors to get twice the gross profits, one must first determine the amount of the gross profit. The net worth method, from an accountant's point of view, provides a complete snapshot of a person's financial affairs over a specified period.

#### **5.4.1 Continuing Criminal Enterprises**

Congress, in addition to the RICO Act, passed the Continuing Criminal Enterprise (CCE) Act. This act was passed by Congress to combat drug trafficking. 21 USC 848 defines a continuing criminal enterprise as any person, in concert with five or more people, who occupies a position of organizer and supervisor and who obtains substantial income or resources. The alternative is "a defendant who derives profits or other proceeds from an offense may be fined not more than twice the gross profits or other proceeds" (21 USC 855). It is clear from this statute that prosecutors can use the net worth method of proving illegal gains and identifying assets for forfeiture.

#### **5.4.2 Connection**

In *United States v. J.C. Pate Jr.*, the Court of Appeals, 11th Circuit, made a ruling in a drug forfeiture case: to demonstrate the substantial connection between property and illegal drug transaction in forfeiture action, the government is not required to show the relationship between property and a specific drug transaction. However, the claimant can meet his burden of proof in civil forfeiture proceedings by establishing with a preponderance of evidence that the property is not subject to forfeiture either by rebutting the government's evidence that the property represents proceeds of illegal drug activity or by showing that the claimant is an innocent owner without knowledge of the property's connection with illegal drug activities. In order to establish probable cause for forfeiture under Section 881(a)(6), the government must show that "a substantial connection exists between the property to be forfeited and an illegal exchange of a controlled substance." The government's burden of demonstrating probable cause requires "less than prima facie proof but more than mere suspicion." The net worth method is considered one of the best methods of showing the relationship between illegal gains and the related asset acquisitions if properly prepared and documented.

## 5.5 When Use Is Required

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The net worth method should be used in tax cases when one or more of the following conditions prevail:

1. Subject maintains no books and records
2. Subject's books and records are not available
3. Subject's books and record are inadequate
4. Subject withholds books and records

A taxpayer's keeping of accurate records does not prevent the use of the net worth method. The government can still use the method to either confirm or deny the taxpayer's declarations. It can be used in organized crime, illegal activities, or general fraud cases. The net worth method can be used as a primary means of proving taxable income, or it can be used to corroborate or test the accuracy of reported taxable income.

The net worth method should be used in RICO cases when one or more of the following conditions prevail:

1. The target acquires a large amount of assets.
2. The target spends beyond his means.
3. The target is a high-level drug trafficker where most, if not all, witnesses against him are drug distributors for him.
4. Illegal income needs to be determined in order to determine the forfeiture amount.

## 5.6 Theory

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When the determination has been made to use the net worth method, then the questions of how to prepare and present items on the net worth schedule arise. The following guidelines are provided.

As a general rule for tax purposes, items on the net worth schedule should be treated in the manner prescribed for tax purposes. Only cost figures should be used. Market values can be used, but only in extreme or unusual circumstances or if the tax law and regulations require it.

As a general rule for RICO purposes, the source and use of funds principle is to be applied. Only cost figures should be used. Market values cannot be used unless they relate, either directly or indirectly, to the source and use of funds. No phantom figures are to be used. Phantom figures are defined as accounting entries for amortization, depreciation, and depletion allowances. These figures do not reflect the use of funds and therefore should not be used.

### 5.6.1 Cash on Hand

You must anticipate this particular problem and show that the taxpayer had no large sum of cash for which he or she was not given credit. Consequently, it is important that you interview the taxpayer early in the investigation to tie down a maximum cash accumulation. You should attempt to obtain the following:

1. The maximum amount claimed to be on hand at the end of each year from the starting point through the present
2. How it was accumulated (from what sources)
3. Where it was kept and in what denominations
4. Who had knowledge of it
5. Who counted it
6. When and where it was spent

All of the above information is necessary to establish the consistency and reliability of the taxpayer's statements. Usually no direct cash-on-hand evidence is available, but statements made as to the sources, amount, and use of funds can be corroborated or refuted with circumstantial evidence.

Examples of evidence that may tend to negate the existence of a cash hoard include:

1. Written or oral admissions of the taxpayer to investigating officers concerning a small amount of cash on hand
2. Financial statements prepared by the taxpayer showing a low net worth or cash on hand
3. Compromises of overdue debts by the taxpayer
4. Foreclosure proceedings against the taxpayer
5. Collection actions against the taxpayer
6. Tax returns (or no returns) evidencing little or no income in prior years
7. Loan records
8. Consistent use of checking and savings accounts

It may be possible to reconstruct the taxpayer's cash on hand from prior earnings records. If cash on hand for an earlier period can be reasonably established, income earned from that period to the starting point of the net worth schedule could be used to establish the maximum available cash on hand.

The problem for cash on hand or cash hoard is the same as that for both RICO net worth purposes and tax net worth purposes. However, for tax purposes, the agent is more likely to interview the taxpayer, while for RICO net worth purposes, the investigator either will not want to interview the target or will not be able to do so because of some legal or safety reason.

### **5.6.2 Cash in Banks**

The main problem here can be whether to use the bank statement balances or the book balances. Either can be used; however, if book balances are used, then bank reconciliations must be provided as well. Whether book balances are used or bank balances are used, you must be consistent in their use. One cannot use book balances for one year and bank balances the next. Bank balances can be used from some bank accounts, while book balances can be used for other bank accounts. Each bank account must use a consistent method.

### **5.6.3 Inventory**

Taxpayers tend to understate their inventories by using various devices. Stealing or fencing stolen goods can make large profits. This is particularly true in business "bust outs," when a

taxpayer purchases inventory on credit at one location and transports the inventory to another location, where it is sold off, leaving the creditors holding the bag. A problem arises in correcting continuing understatements of inventory. The resulting increase in closing inventory in a closed year creates a deficiency that could not be corrected due to statute of limitations. A possible remedy in this situation is Internal Revenue Code (IRC) 481, regarding changes in method of accounting. The agent should verify inventory in stock. Internal Revenue Manual (IRM) 424(10) provides the minimum tests to be made. In using the RICO net worth method, it is unlikely that the investigator can verify inventory. The investigator might be able to verify inventory from surveillance photographs, if a surveillance was done. Otherwise, the investigator will have to use some other method of determining inventory, usually from witness testimony or by computation based on a constant gross profit percentage.

#### **5.6.4 Accounts/Loans Receivable**

Normally, the investigator can confirm and verify receivables whether using RICO or tax net worth methods by third-party contact. Problems arise in this area where related parties are involved, especially if they are subjects of the investigation, whether it be individuals, partnerships, or corporations. Remember, a receivable on the taxpayer's books must be a payable on the other, and the amounts must agree for both principal and interest.

#### **5.6.5 Intercompany Transfers**

Shareholders can invest in multiple corporations and partnerships. These corporations or partnerships can transfer funds or goods between each other. Whether it is for tax or RICO purposes, these transfers should be ignored as to the individual net worth. The additional investment in a particular corporation should be reflected on the individual net worth. Whatever the corporation or partnership does with the money is a matter of the entity. In the case of partnerships and Sub S corporations, basis reverts back to the original entity that received the funds from the individual.

#### **5.6.6 Sole Proprietorship**

The tax net worth only requires that the assets and liabilities be shown on the sole proprietor. The RICO net worth requires not only the assets and liabilities of the sole proprietorship, but also the income and expenses. For RICO purposes, the problem lies in converting the sole proprietorship into a fund statement. Remember, all depreciation, amortization, and depletion expenses must be reversed out. Only cash expenses should be shown. If the sole proprietorship keeps its books on the accrual method, then the assets, liabilities, income, and expenses should be shown on the individual net worth after adjustments for the accountant's depreciation, amortization, and depletion deductions.

#### **5.6.7 Exchanges**

Individuals at times will pay for the expenses of another person. In turn, the other person will pay the individual back. The reverse is that another person will give the individual funds to pay for the expenses of the other person. There are two ways of showing this situation. First, the expenses can be shown as an expenditure and the reimbursements can be shown as a source (nontaxable in the tax net worth method) of income. The second method is to show the receipts as a receivable, and any reimbursement shows a decrease in the receivable.

## 5.7 Securities

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Subjects have a tendency to report to financial institutions the fair market value instead of the cost. For net worth purposes, only cost figures can be used. Another problem to face with securities is how the subject acquired the securities by means other than direct purchase. The basis must be firmly established and any doubts should be made in favor of the subject. Drug traffickers use commodities to launder their money. Commodities such as gold and platinum, and securities such as bearer bonds, can be transported much easier than hauling around cash. Also, they are easier to convert back into currency. This is where currency transaction reports and IRS 8300 forms should be obtained, if possible, and examined for leads.

### 5.7.1 Personal Property

Actual cost figures must be used in reflecting personal property, i.e., cars, boats, furniture, jewelry, etc., instead of fair market values. The cost of cars, boats, and airplanes can be determined from state and federal agencies, whereas the costs of other personal property cannot be unless the investigator discovers them from canceled checks or some other source by chance. Surveillance of the subject to expensive stores will be very helpful. Also, the proceeds from disposition of nontraceable personal property are hard to trace unless the subject deposits a check into his bank account. The main thrust here is to fully document nontraceable personal property by third-party confirmation. The county tax assessor's office maintains files for tangible personal property that is used in business operations. These tangible personal property tax returns show costs of personal property used in business operations.

### 5.7.2 Real Property

Real estate must be reported at cost instead of fair market value. However, real estate is probably the easiest to verify because these records are easily accessible at the county records department. In Florida, the state document stamps are charged by set rates upon the purchase price of the real property. In addition, the tax assessor is supposed to assess real property at two thirds the market value. The problem with real property records is that sometimes they are difficult to read from microfilm, and if real property is transferred by quitclaim deed, no purchase price is reflected from the document stamps. Quitclaim deeds are usually between related parties.

### 5.7.3 Cash Value Insurance

The subject sometimes has life insurance that has cash values (called whole life policies). The subject has access to these cash values and can withdraw by either borrowing or canceling the policy. The investigator will have to break down the premium between cash value and insurance expense for both RICO and tax net worth purposes. This information can readily be obtained from the insurance company.

### 5.7.4 Subchapter S Corporation

Subchapter S corporations are treated differently from Chapter C corporations for tax purposes. In Chapter C corporations, the investigator picks up his net cash investment in

the corporation. In Sub S corporations, the investigator not only picks up the net cash investment, but also makes allowances for any income and losses attributed to the subject from such entity, but never below zero (no negative basis). For RICO net worth purposes, the Sub S corporation is treated the same as Chapter C corporations, which is net cash investment in the corporation. This is definitely an item that will have a different effect between the RICO net worth and tax net worth.

### **5.7.5 Partnership**

Partnerships are treated similarly to Subchapter S corporations. The investigator picks up his net cash investment plus makes allowances for the subject's share of income and losses. However, the subject can have a negative basis, but only to the extent at which the taxpayer is at risk. Nonrecourse financing is considered not at risk and therefore cannot be used in having a negative basis. For RICO net worth purposes, only net cash investment is considered. This is another item that will have a different effect between the RICO and tax net worths.

### **5.7.6 Prepaid Insurance**

The problem here is whether to reflect prepaid insurance, or any other expense for that matter, as an asset and show a write-off in subsequent periods or just reflect one lump-sum expenditure. Since the subject can cancel the insurance before its expiration, prepaid insurance should be capitalized and later amortized based on potential refund of the premium for tax net worth purposes. However, for RICO net worth purposes, prepaid insurance should be expensed in the year incurred. Phantom costs, such as amortized costs, are not to be recorded in subsequent years on RICO net worth schedules.

### **5.7.7 Controlled Foreign Corporations (CFEs)**

For tax net worth purposes, the agent should pick up not only the net cash investment, but also the taxpayer's share of net income. For RICO net worth purposes, only the subject's net cash investment should be used. Another problem that arises in foreign corporations is the effect of foreign exchange rates. Gains and losses from foreign exchange rates will have to be reflected for both tax and RICO net worth computations. On RICO net worth schedules, gains are identified sources and losses are identified expenses.

### **5.7.8 Accounts Payable**

Accounts payable is used for accrual taxpayers only. A problem can arise when payables are from related persons or entities, which are not on the accrual basis. For RICO purposes, accounts payable is not used, since this would defy the fund concept that RICO net worths are based on. However, if the subject has a sole proprietorship with inventory and cost of sales, then accounts payable will have to be used on the RICO net worth schedule.

### **5.7.9 Credit Cards**

In a net worth, credit card balances are shown as a liability, and the total charges are reflected in the personal expenditure section. One problem that could arise at year end is when charges are made but do not show up until the subsequent period. There is sometimes

a lag as long as 2 or 3 days or more. Also, the charges have to be confirmed and differentiated as to what is personal or business, especially for those credit cards that have widespread use. Another method of presentation is where no liability is reflected on the net worth, and only the payments are reflected to the credit card company as a personal expenditure. The agent still has the problem of distinguishing between business and personal use, as well as expenses vs. assets. Credit cards cannot be ignored because the funds spent can be enormous. The problem with credit cards is the same for both tax and RICO net worth purposes. Whether you use the total charges and ending liability presentation or the total payment expenditure presentation, you must be consistent with only one presentation. For RICO purposes, there is really no need to distinguish business and personal charges, since they are just expenditures. The agent, however, must distinguish between expenses and assets.

#### **5.7.10 Deferred Gains**

This item comes about when the taxpayer reports sales on the installment method or is allowed to use the installment method to report a gain. For tax purposes, the agent will have to set up a deferred gain in the liability section of the net worth schedule, and recognize the gain in subsequent periods based on receipts. For RICO purposes, deferred gains are not recognized in subsequent periods. They are recognized in full when they are incurred.

#### **5.7.11 Prepaid Interest**

This item comes about from installment loan contracts. The installment loan is recorded by the bank with principal, interest, and other charges combined. Interest should be recognized the same way that a bank recognizes the interest income. It should be noted that when the installment method is paid off early, the bank uses a different method of rebating the interest (called the rule of 78) from the method used in computing the interest. The Internal Revenue Service issued a ruling that the rule of 78 cannot be used in computing interest expense by the taxpayer. For RICO purposes, prepaid interest is not capitalized and later amortized. Prepaid interest is expensed in the year incurred.

#### **5.7.12 Contributions**

Cash contributions are treated the same for both tax and RICO net worth purposes. In the case of noncash contributions, tax net worth computations reflect the fair market value, but not more than the original cost. For RICO net worth computations, only cost figures should be used.

#### **5.7.13 Capital Gains and Losses**

Capital gains and losses are treated differently for tax net worth purposes vs. RICO net worth purposes. For tax purposes, losses are limited to \$3,000 per year. This will result in an asset called deferred capital losses. For capital gains prior to 1987, the gain will be recognized, but a portion of the gain, called 1202 deduction, will be shown as nontaxable income. RICO net worths must recognize the gains and losses in full during the period incurred.



### **5.7.14 IRA and Keogh Accounts**

People are increasingly funding Individual Retirement Accounts (IRAs) and Keogh plans for self-employed individuals. The contributions to these plans are tax deductible, and the interest and dividend income is tax-free. On tax net worth computations, these retirement plans should be reflected as an asset, and the interest and dividend income should be reflected as nontaxable income. On RICO net worth computations, these retirement plans should be reflected as an asset, and the income appropriately recognized as identified income.

### **5.7.15 Personal Living Expenses**

There are other expenses that should be considered in doing a net worth computation, whether for tax or RICO purposes. These expenses should be identified as early as possible and records obtained. They are as follows:

1. Food and outside meals
2. Home and other repairs
3. Utilities, i.e., electric, water, waste, etc
4. Telephone. Both the charges and payments, as well as toll calls should be obtained. Toll calls can help tie the target to other individuals as well as offer leads for additional financial information
5. Vacations or trips
6. Alimony
7. Child support
8. Property taxes
9. Medical expenses, including health insurance
10. Educational expenses
11. Moving expenses
12. Gifts
13. Federal and state income taxes
14. Personal bad debts

### **5.7.16 Various Income Items**

There are income items that should be kept in mind. Some items will have different effects on net worth computations from tax vs. RICO purposes. RICO net worths will probably use income items that tax net worths will either not use or present differently. Some of these items are:

1. Tax exempt interest
2. Social Security benefits
3. Unemployment compensation
4. Dividend exclusion
5. Life insurance proceeds
6. Inheritance
7. Disability income
8. Two-wage-earner deduction

9. Educational assistance
10. Military allowances
11. Casualty insurance proceeds

## 5.8 Civil vs. Criminal

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In tax cases, there usually are differences between the criminal case and the civil case. The primary reason is that the civil agent is trying to establish a tax deficiency, while the criminal agent is trying to show intent to defraud the government. The criminal agent has to interview and have witnesses testify about various income and expenditure items. The civil agent does not have to obtain very many witnesses, since deductions are the responsibility of the taxpayer and not the government. The following items will inevitably reflect differences between criminal and civil agents' reports.

1. Dividend vs. reduction in capital investment in corporations
2. Interest vs. loan
3. Personal expenditures. Civilly, the taxpayer must prove deductions; criminally, the government must prove deductions
4. Basis of assets, i.e., auto basis on trade-ins

In RICO cases, the net worth computation is used for both criminal and civil purposes. There should be little or no differences. The only differences that might appear in RICO cases are items that were not admitted in criminal court because they were unknown at the time, just were not introduced, or the hearsay rules forbid their use in criminal proceedings, but not in civil proceedings. Otherwise, there should be no difference in technical issues.

### 5.8.1 Defenses

Whenever using any indirect method to determine correct taxable income or to determine the amount of illegal gain from an illegal enterprise, the defendant will have various defenses. Some of the more common ones are:

1. **Cash on hand.** This is the cash hoard story. The defendant claims to have accumulated wealth in years prior to the prosecution years.
2. **Loans.** The defendant testifies that the sudden wealth came from somebody or some entity as loan proceeds. In some cases, the lender does not have the resources to make any loans to the defendant. This is common with loans from relatives, family members, and closely held corporations.
3. **Gifts.** The defendant claims to have received gifts from family members, relatives, or friends. The investigator should verify whether the donor has the resources to make such a gift to the defendant.
4. **Inheritance.** When the defendant claims inheritance as a sudden source of wealth, the investigator should check probate court records. If the inheritance is very large, it could make the defendant liable for possible estate tax fraud if no estate tax returns were filed, whether for federal or state purposes.

5. **Innocent bystander.** The defendant could claim to be an innocent bystander where money was left in his possession while another person was on the run.
6. **Agent or nominee.** Defendants like to deny ownership and place assets in nominees or alter egos. The investigators should determine whether the nominee or alter ego has the resources to acquire the assets. (The issue of nominees and alter egos is addressed in Chapter 19.)
7. **Possession.** The defendant may claim that he is an agent for an anonymous person, or he was unaware the goods were in his possession.
8. **Jointly held assets.** The defendant may claim that the other party purchased the jointly held assets. The investigator should confirm the other party to the purchase transaction of the jointly held asset. If the other party purchased it, then the asset should not be shown on the net worth schedule.
9. **Overstated inventories.** The defendant may claim that the inventory or other assets are overstated. The investigator should confirm with the subject (if permitted), employees, and records, or some covert means as available.
10. **Failure to account for other sources of funds.** The defendant may not be able to account for all sources of income. It is the duty of the investigator to check all possible sources of income.
11. **Commodities.** The subject claims the purchase of commodities, i.e., gold, silver, auto parts, etc., that were accumulated prior to the prosecution years. The investigator has the difficult job of confirming this claim.

Remember, particularly in criminal cases, whether for tax or RICO, the burden of proof is placed on the government when a net worth method is used. In the Holland case, the Supreme Court said:

1. The government is responsible for establishing the opening net worth with reasonable certainty. This includes verification of the subject's admissions.
2. There must be significant signs that there is a likely source of taxable income, and the government must refute nontaxable sources for tax purposes. In RICO cases, it is evident that all sources of any legal income should be identified.
3. If the subject offers any leads of income, they must be investigated and accepted or refuted.

In RICO cases, the defendant will use the same defenses as in tax cases. The tendency in RICO cases is to try to introduce more legitimate income or disclaim ownership of various assets. Organized crime figures and high-level drug traffickers have the pattern of using nominees or agents to hide their assets and illegal income. The investigator, in these situations, has to determine if the agent or nominee has the ability to acquire assets or generate that kind of legal income.

## 5.9 Summary

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The net worth method, whether for RICO or tax purposes, is a very powerful tool. It tends to place the burden upon the defendant to disprove, once introduced into evidence. The examiner or investigator has the tedious job of locating, obtaining, analyzing, and prepar-

ing a net worth schedule. The examiner has to pay close attention to all the details presented in the net worth schedule. All the issues should be identified and resolved.



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# Expenditure Theory

# 6



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## 6.1 General

The Internal Revenue Service was the first to use the expenditure method. The expenditure method is a derivation of the net worth method, which has been used since the early 1940s. Like the net worth method, the expenditure method is used to determine the amount of unreported taxable income. This method is appropriate in cases where the taxpayer does *not* accumulate assets, but spends all his income on lavish living. When the Racketeer Influenced and Corrupt Organization (RICO) act of 1970 was passed, the expenditure method was expanded to encompass organized crime figures.

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## 6.2 Tax Use

The expenditure method is a method of proof by circumstantial or indirect evidence. The IRS establishes the total expenditures, less total nontaxable sources, to arrive at adjusted gross income. Exemptions and itemized deductions are subtracted to arrive at corrected taxable income. This is compared to the reported taxable income to arrive at any unreported taxable income. Table 6.1 is presented to illustrate the theory.

**Table 6.1 Tax Expenditure Theory**

	Year
Total	Expenditures
Less:	Total Nontaxable Source
Equals:	Adjusted Gross Income
Less:	Itemized/Standard Deduction
Less:	Exemptions
Equals:	Corrected Taxable Income
Less:	Reported Taxable Income
Equals:	Unreported Taxable Income

### 6.3 RICO Use

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Like the net worth method, the expenditure method is used in RICO and other economic crime cases. In a RICO case, the basic objective is to determine the amount of illegal income. The RICO method is defined as total expenditures less legal sources to derive at illegal income. The RICO expenditure does this for each succeeding year. Table 6.2 is presented to illustrate the theory.

### 6.4 History

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The expenditure method came into use in the early 1940s. Since then, it has been used more frequently than the net worth method. There are various reasons for this. First, it is more easily prepared. Second, it is easier to explain to a jury in a trial. The expenditure method has not been ruled upon directly by the U.S. Supreme Court. One reason is that the expenditure method is a derivation of the net worth method. Any accountant can take a net worth computation and convert it to an expenditure computation and vice versa. The Supreme Court in its decisions in net worth cases has referred to the net worth and expenditure methods. This alone implies that the Supreme Court approves of the expenditure method. As such, the rules the Supreme Court outlined in net worth cases apply to expenditure cases.

The Internal Revenue Service has been using the expenditure method against the ordinary average citizen. It can be used to show that the taxpayer books do not reflect true income or to corroborate specific adjustments. Revenue agents sometimes use the expenditure method by using figures on the tax return even before beginning their examinations or contact with the taxpayer. Revenue agents call this expenditure method the T account. The T account method is actually the expenditure method, in which sources of income are reflected on the left side of a spreadsheet. The expenditures are shown on the right side of the same spreadsheet. If the right side of the spreadsheet, the expenditure side, is greater than the left side, the income side, then the revenue agent will suspect that the taxpayer has unreported taxable income.

The tax court and some district courts have, on occasions, disapproved the expenditure method. The primary reason is that the Internal Revenue Service failed to establish the amount of funds available at the beginning of the taxable years in question. Like the net worth method, the prosecution has to show that the taxpayer does not have a cash hoard or other convertible assets prior to the prosecution years.

#### 6.4.1 RICO Use

The expenditure method, like the net worth method, can be used in the prosecution of organized crime figures and drug kingpins. In these cases, the primary use is to show the amount of illegal income. When the illegal income is determined by the expenditure

**Table 6.2 RICO Expenditure Theory**

	Year
Total	Expenditures
Less:	Legal Sources
Equals:	Illegal Income

method, the prosecution can recommend the fine. Unlike the net worth method, the expenditure method does not identify the assets the defendant has accumulated. It only identifies the assets acquired in any specific year. It does not mean that the defendant still has those assets. The expenditure method can identify sales and disposition of assets, but only in the year of disposition. Assets can be destroyed or abandoned, and the investigator may not learn of it right away. In addition, assets can be disposed of after the years under examination or investigation.

## 6.5 When Use Is Required

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The expenditure method should be used in tax cases when one or more of the following conditions prevail:

1. Taxpayer maintains no books and records.
2. Taxpayer's books and records are not available.
3. Taxpayer's books and records are inadequate.
4. Taxpayer withholds books and records.
5. Taxpayer has no visible or identifiable assets.

The expenditure method should be used in RICO cases when one or more of the following conditions prevail:

1. The target does not seem to acquire assets.
2. The target spends beyond his means — lavish living.
3. The target is a high-level kingpin where most, if not all, witnesses against him are convicted criminals.
4. Illegal income needs to be determined in order to determine the fine or forfeiture amount.

## 6.6 Theory

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When the determination has been made to use the expenditure method, then the questions of how to prepare and present items on the expenditure method arise. The following guidelines are provided.

As a general rule for tax purposes, items on the expenditure schedule should be treated in the manner prescribed for tax purposes. Only cost figures should be used. Market values can be used, but only in extreme or unusual circumstances or if the tax law and regulations require it.

As a general rule for RICO purposes, the source and use of funds principle is to be applied. Only cost figures should be used. Market values cannot be used unless they relate, either directly or indirectly, to the source or use of funds. No phantom figures are to be used. Phantom figures are defined as accounting entries for amortization, depreciation, and depletion allowances. Also, earnings and profits from partnerships and corporations are not to be used. These figures do not reflect the use of funds and therefore should not be used.



The expenditure method treats assets and liabilities different than does the net worth method. Assets and liabilities are shown on the expenditure method during the period that they are acquired or disposed of. Accumulated or ending balances are not shown on the expenditure method. Those items that are presented in a different manner are discussed below.

### **6.6.1 Cash on Hand**

The net worth method reports the amount of cash on hand at year-end. The expenditure method reports either the increase or decrease in cash on hand from one year to the next. However, the same rules apply as to the determination of cash on hand for each year under investigation, as well as for prior years. The cash hoard defense applies to the expenditure method as well as the net worth method. If the subject has or claims cash hoard, then the cash hoard will decrease over the periods under investigation.

### **6.6.2 Cash in Bank**

The expenditure method reports either the increase or decrease of cash in the bank rather than the bank or book balances. Whether the book or bank balances are used, the use must be consistent. You cannot use book balance increases or decreases in one year and bank balances in a subsequent year. This applies to both tax and RICO purposes. However, for increases and decreases in different bank accounts, bank balances can for be used for one account and book balances for another.

### **6.6.3 Inventory**

The expenditure method has the same presentation problems as the net worth method, except in the expenditure method, the inventory is stated by the increase or decrease in ending inventory balances. It is suggested that the investigator determine the inventory balance, and then determine the increase or decrease by subtracting the beginning and ending inventory balances for the period.

### **6.6.4 Intercompany Transfers**

Intercompany transfers should be ignored on the individual expenditure schedule. Only the initial investment should be accounted for on the individual expenditure schedule. What the corporation or partnership does with funds has no effect on the individual expenditure schedule.

### **6.6.5 Sole Proprietorships**

The net changes in assets and liabilities should be reflected on the individual expenditure schedule, whether the tax or RICO method is used. The income and expenses should be reflected on the RICO expenditure schedule. The examiner will have to make adjustments to eliminate any phantom figures (accountant's depreciation, amortization, and depletion allowances). The tax expenditure method does not reflect the income and expenses of a sole proprietorship, since they relate to net income or loss, to derive adjusted gross income.

### **6.6.6 Exchanges**

Both the tax and RICO methods should reflect exchanges identically. This means that payments to or on behalf of other people should be reflected as expenditures. Any reimbursements should be reflected as a source of funds. For the tax method, this source of receipts should be reflected as a nontaxable source of income. Another method of reflecting exchanges is to show the net effect of exchanges. This applies to both the tax and RICO methods. If the net effect is an expenditure, then this should be shown in the expenditure section. If the net effect is a source, then it should be shown as a source of funds. In RICO cases, this is a source of receipts.

### **6.6.7 Accounts/Loans Receivable**

The expenditure method shows the increases or decreases in the accounts and loans receivable. It also does not show the year-end balances. The investigator has the same problems in the expenditure method as in the net worth method: the year-end balances must be confirmed before the differences can be determined. The related-party issue in this area is the same as in the net worth method. The increase or decrease in loans and accounts receivable on the subject's books must correspond to the opposite increase or decrease on the related-party books. The examiner must determine if related-party loans are bona fide. The related party may not be able to make large loans.

### **6.6.8 Subchapter S Corporation**

For tax purposes, the expenditure method accounts for the total earnings or losses plus any contributions less any withdrawals for the period. The net worth method only shows the beginning and ending balances for the period. For RICO purposes, the expenditure method accounts for the net change during the period as to the subject's cash investment. Earnings and losses are not accounted for in this computation. Regular corporations are treated the same for both RICO and tax purposes. The net changes in cash investment for the period are reflected on the expenditure computation.

### **6.6.9 Partnership**

For tax purposes, the expenditure method accounts for the total earnings or losses plus any contributions less any withdrawals for the period. Negative changes can be reflected for both RICO and tax purposes. However, for tax purposes, the negative changes will not be allowed if the taxpayer is not at risk on loans that the partnership has acquired.

### **6.6.10 Credit Cards**

The net change in credit card balances is reflected on the expenditure method if the total charges are shown on the expenditure schedule. It is easier for both the examiner and investigator to reflect the net cash payments to the credit card companies than to reflect total charges and changes in credit card balances. For tax purposes, the payments for business expenses have to be separated from personal expenses. This can be extremely difficult. Interviews of witnesses or the subject will have to be done to determine the nature of the expenditures. The best evidence on credit card payments is to see how the taxpayer paid for the credit card bills. If the payments came from his personal bank accounts, then

it is obvious that they are personal expenses. If paid from a business account, then it implies that they are for business purposes. This can leave the investigator open for debate between both counsels. For RICO purposes, this is not an issue.

### **6.6.11 Other Assets**

The net change in assets is reflected on the expenditure method, whether tangible or intangible or real or personal property. In tax cases, the expenditure will reflect a decrease in intangible assets, such as prepaid interest and insurance. In RICO cases, prepaid items are not recognized since they do not exist. Prepaid items on the RICO expenditure schedule are expensed in the year incurred.

### **6.6.12 Loans and Mortgages Payable**

The expenditure method shows only the receipt of the funds borrowed (source of funds) during the period and the total payments (application of funds) made during the period. Loan proceeds should not be netted out with loan repayments. This can be confusing for the jury.

### **6.6.13 Income and Expenses**

Income and personal living expenses are reflected the same way for expenditure computations as they are for net worth computations — actual disbursement of funds. This applies to both tax and RICO purposes. The tax expenditure method recognizes only nontaxable sources of income. Expenses are recognized when paid for cash basis taxpayers and when incurred for taxpayers on the accrual method. The RICO expenditure method recognizes all personal income and expenses of the subject when received or paid. However, if the subject has a sole proprietorship that is on the accrual method of accounting, then the income and expenses should be recognized when incurred, along with the changes in accounts payable.

### **6.6.14 Deferred Gains**

Deferred gains are not recognized on the RICO expenditure method. Gains are recognized in full when incurred. For tax purposes, deferred gains are recognized by showing an acquired liability. Since this is an adjustment to arrive at adjusted gross income, it will be reflected on the expenditure schedule as a nontaxable source.

### **6.6.15 Depreciation, Amortization, and Depletion**

Depreciation, amortization, and depletion are not recognized on the RICO expenditure schedule since these are accountant figures that do not relate to the use of funds. In tax cases, depreciation, amortization, and depletion allowances are shown as an accumulated liability, but not as a personal living expense. The Internal Revenue Code and regulations govern the amount that can be claimed.

### **6.6.16 Controlled Foreign Corporations (CFCs)**

For tax purposes, the investigator should pick up the net cash investment plus the taxpayer's income and loss for the period. For RICO purposes, only the subject's net cash investment

for the period should be used. These net investment figures should be in U.S. currency. Any gains and losses should be reflected in other sections of the expenditure schedule. This applies to both tax and RICO purposes. However, for tax purposes, losses will be limited to the loss limitation rules.

### **6.6.17 IRA and Keogh Accounts**

On tax expenditure schedules, Individual Retirement Accounts and Keogh plan contributions should show the amount of the contributions plus earnings for the period. Earnings for the period are reflected as a nontaxable source. For RICO purposes, the plan contributions are shown as an expenditure plus any earnings. However, the earnings for the period are reflected as a source of income.

### **6.6.18 Capital Gains and Losses**

There are differences between the tax expenditure method and the RICO expenditure method. For tax purposes, capital losses are not recognized on the expenditure computation, because they are adjustments to arrive at the adjusted gross income. However, losses in excess of the amount allowed to be deducted during the period should be shown as an intangible asset. This intangible asset is reduced by the amount of loss allowed in subsequent years. For RICO expenditure purposes, both gains and losses are recognized for the period in the appropriate section — income or expense. In addition, the recovered costs are to be reflected in the source section. In RICO cases, it is easier to show the gross proceeds from the sale of capital assets as a source, and reflect the cost of the asset as an expenditure.

## **6.7 Civil vs. Criminal**

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Like the net worth method, the expenditure method has the same issues and will have to solve them in somewhat the same manner. In tax cases, there will be differences between a criminal and civil case. This is due primarily to the degree of proof required in criminal cases, which is greater than in civil cases. In tax civil cases, issues can become more technical than in criminal cases. In RICO cases, there should be little or no differences. Any difference usually relates to the admissibility during criminal proceedings or later discovery of additional items.

### **6.7.1 Defenses**

The defenses for the expenditure method, whether tax or RICO, are the same as for the net worth method. In criminal cases, the burden of proof is the responsibility of the government when the expenditure method is used. The cash hoard or conversion of old assets is the most used defense in the expenditure method. Any defense will have to be investigated and refuted. The expenditure method will have to use the same investigative techniques to refute any cash hoard or asset conversion as used in the net worth method. Defense attorneys use the same defenses in both expenditure and net worth cases.

## 6.8 Summary

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Like the net worth method, the expenditure method is a powerful tool. It also tends to place the burden upon the defendant to disprove, once introduced into evidence. The examiner or investigator has the tedious job of locating, obtaining, analyzing, and preparing an expenditure schedule. The examiner has to pay close attention to all the details presented in an expenditure schedule. All the issues must be identified and resolved. The principal difference between the expenditure and net worth methods is the presentation of assets and liabilities. The expenditure method only reflects assets and liabilities that are obtained or disposed of during a period.

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# Scenario Case

# 7



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## 7.1 Case

This case is designed to acquaint the reader with how to put together a net worth computation schedule, an expenditure computation schedule, and a tracing schedule for Title 26, U.S. Code (USC) (Income Tax) and for Title 18, USC (Racketeering). It is designed to show the theory and objective. It illustrates these objectives and addresses the most common problems and issues that forensic accountants will encounter.

This case is based on real-life incidents. The material for this case is divided into two parts for the purpose of showing the importance of both financial information and non-financial information and their interrelationships. The first section, “Financial Data,” will provide you with financial data for use in your various computational schedules. The second section, “Intelligence,” will provide you with information about the subject’s activities and dealings. This section also has some financial information, but it is not generally admissible in court because the Federal Rules of Evidence disallow it.

This case scenario is used to prepare four schedules using the theory for both tax and Racketeer Influenced and Corrupt Organization (RICO) purposes. The following chapters will explain in detail and provide the schedules for the following:

1. Net worth schedule for tax purposes
2. Net worth schedule for RICO purposes
3. Expenditure schedule for tax purposes
4. Expenditure schedule for RICO purposes

The tax laws and regulations are the basis for computing a tax net worth or expenditure schedule. The objective is to determine the amount of unreported taxable income. The funds principle is the underlying guide in preparing the RICO net worth or expenditure schedule. No amortization, depreciation, or depletion allowances are allowed in a RICO net worth or expenditure schedule. The objective is to determine the amount of illegal income and identify forfeitable assets. The subsequent chapters show how these schedules should appear and provide explanations as to how each type of schedule was derived.

## 7.2 Financial Data

### 7.2.1 Search Warrant Data

Investigators conducted an authorized search warrant on John Doe's residence on December 31, 19X3. During this search, the following items were discovered and seized:

1. Cash found in a floor safe, \$50,000.
2. Two kilos of cocaine. The wholesale value at the time of the search warrant was \$25,000 per kilo.
3. Bank statements in the name of John Doe from Barclays Bank of London, England. The statement transactions are given below in British pounds (BL). At the time of deposits, the exchange rate was U.S.\$1.00 = BL\$2.00.

Date	Deposits	Withdrawals	Balance	Interest
1/28/X1	\$1,000,000		\$1,000,000	
2/10/X1	1,000,000		2,000,000	
3/15/X1	2,000,000		4,000,000	
3/30/X1			4,120,000	\$120,000
5/1/X1		\$2,000,000	2,120,000	
6/30/X1			2,203,600	83,600
7/2/X1		2,203,600	0	

4. Ten gold bullion bars were found at his residence in a hidden compartment in the kitchen cabinets. The market value at time of seizure was \$20,000 per bar.

### 7.2.2 Public Records

During the investigation, the following data were discovered in county public records:

1. John Doe purchased his residence at 100 Alpha Street. The warranty deed shows that the purchase was on 1/30/X1. The document stamps paid on the purchase were \$1,500. Document stamps are based on \$5 per \$1,000. A mortgage is recorded along with the warranty deed. The mortgage shows that John Doe obtained a mortgage for \$250,000. The mortgage states that monthly payments of \$1,000 per month plus interest at 10% per annum are due, commencing 3/1/X1. The lender is Panama Mortgage Company, a foreign corporation (Panama Republic).
2. On 5/8/X1, John Doe purchased an apartment building on 100 Bravo Street. The warranty deed shows that the document stamps paid were \$20,000. Document stamps were paid on the purchase price of \$5 per \$1,000. A mortgage is recorded at the same time by Florida Mortgage Corp., a domestic corporation. The principal amount is \$2 million. Monthly payments are \$10,000 per month plus interest until the mortgage is paid, commencing 6/1/X1. The interest rate is 10%.

### 7.2.3 Life Insurance

John Doe purchased a life insurance policy for \$10,000 on 6/30/X1. The policy is for \$1 million, with John Doe's mother as beneficiary. This is a whole life policy. Doe paid 5 years at one time. The policy shows the cash value as follows based on annual installments of \$2,000:

Date	Value
19X1	\$0
19X2	2,000
19X3	3,000
19X4	5,000

### 7.2.4 Home Improvements

John Doe purchased furniture and fixtures for his house. Receipts obtained show the following purchases from vendors:

Description	Amount	Date
Furniture	\$50,000	2/2/X1
Cabinets	20,000	2/3/X1
Paintings	20,000	3/1/X1
Fixtures	10,000	4/1/X1
Pool and tennis court	100,000	7/1/X1
Appliances	20,000	9/1/X2
Electronic equipment	100,000	9/1/X2
Security system	50,000	2/1/X3

### 7.2.5 Corporations

A check with the State Bureau of Corporations shows that John Doe is the owner of the following entities. All these entities were formed on 10/1/X1.

1. Lounge Doe, Inc. — a Florida corporation
2. Doe Kwik Stop, Inc. — a Florida corporation
3. Real Property Co., Ltd. — a Florida partnership

### 7.2.6 Individual Tax Returns

The individual tax returns were obtained on John Doe. They showed the following data:

Description	19X0	19X1	19X3
Wages	\$10,000	\$190,000	\$200,000
Sole proprietor			(250,000)
Lounge Doe dividend		100,000	
Doe Kwik Stop		(25,000)	175,000
Real property		(100,000)	(30,000)
Rental property Sch E		(70,000)	(30,000)
Adjusted gross	10,000	95,000	65,000
Deductions:			
Standard	3,000		
Mortgage interest		25,000	22,600
Property taxes		5,000	5,000
Exemptions	2,000	2,000	2,000
Taxable income	5,000	63,000	35,400
Tax liability	500	15,750	7,000
Refund in 19X1	500		
Refund in 19X2	79,250		
Withholding	1,000	95,000	150,000

John Doe filed a Schedule C for his sole proprietorship with the returns that he filed. John Doe did not file his tax return for 19X2. This business sells women's clothes. Suzy Que runs the business after she quits her bank job. John Doe does not manage the business



and frequently checks the business operations. The tax return and financial statements provide the following information:

## A. Balance Sheet Presentation

Balance Sheet	19X2	19X3
Cash in bank	\$20,000	\$10,000
Accounts receivable	10,000	20,000
Inventory	140,000	50,000
Business assets	150,000	150,000
Accumulated depreciation	(30,000)	(60,000)
Total	290,000	170,000
Accounts payable	0	50,000
Bank loan payable	100,000	80,000
Capital	700,000	800,000
Accumulated earnings	(560,000)	(760,000)
Total	<u>\$290,000</u>	<u>\$170,000</u>

## B. Income Statement Presentation

Income	19X2	19X3
Sales	\$80,000	\$440,000
Beginning inventory	0	140,000
Purchases	180,000	130,000
Total inventory	180,000	270,000
Ending inventory	140,000	50,000
Cost of sales	<u>40,000</u>	<u>\$220,000</u>
Gross profit	<u>\$40,000</u>	<u>\$220,000</u>
Overhead Expenses		
Advertising	\$80,000	\$40,000
Depreciation	30,000	30,000
Interest	10,000	8,000
Insurance	50,000	50,000
Professional fees	25,000	25,000
Office expenses	30,000	10,000
Rent expense	50,000	50,000
Repairs	20,000	10,000
Supplies	30,000	10,000
Taxes	50,000	40,000
Utilities	40,000	40,000
Wages	120,000	150,000
Miscellaneous	15,000	7,000
Total	<u>\$550,000</u>	<u>\$470,000</u>
Net loss	<u>\$510,000</u>	<u>\$250,000</u>

The business has a part-time bookkeeper who maintains the books. The bookkeeper prepares all the various journals (cash receipts, disbursements, payables, receivables, and purchases). Mr. I.M. Balance, CPA, prepares the individual tax returns for John Doe. In addition, he does a certified audit of the sole proprietorship that is known as Suzy's Women's Clothes. The bookkeeper does the bank reconciliations, but they are reviewed by I.M. Balance, CPA.

## C. Rental Income Schedule

Description	19X2	19X3
Rental receipts	\$200,000	\$450,000
Interest expense	120,000	180,000
Property taxes	20,000	40,000
Insurance	20,000	40,000
Maintenance	10,000	20,000
Depreciation	100,000	200,000
Total expenses	270,000	480,000
Net loss	<u>\$70,000</u>	<u>\$30,000</u>

Note: Depreciation is based on the straight-line method over 15 years.

**7.2.6.1 Lounge Doe, Inc.**

The corporate tax returns and financial statements were obtained. This is a calendar year corporation. The corporate records were also obtained, and they substantiate the tax return figures.

## A. Balance Sheet Presentation

Description	19X1	19X2	19X3
Cash	\$10,000	\$50,000	\$40,000
Inventory	500,000	400,000	300,000
Personal property	500,000	500,000	500,000
Real property	1,000,000	1,000,000	1,000,000
Accumulated depreciation	(50,000)	(200,000)	(350,000)
Land	500,000	500,000	500,000
Organization cost	1,000	900	800
Total assets	<u>\$2,461,000</u>	<u>\$2,250,900</u>	<u>\$1,990,800</u>
Accounts payable	1,000	50,000	40,000
Shareholder loan	2,435,000	2,435,000	2,134,900
Stock	5,000	5,000	5,000
Retained earnings	20,000	(239,100)	(189,100)
Total	<u>\$2,461,000</u>	<u>\$2,250,900</u>	<u>\$1,990,800</u>

## B. Income Statement Presentation

Income	\$1,070,100	\$891,000	\$1,400,100
Cash expenses	100,000	150,000	300,000
Depreciation	50,000	150,000	150,000
Amortized costs	100	100	100
Beginning inventory	0	500,000	400,000
Purchases	1,300,000	750,000	800,000
Ending inventory	500,000	400,000	300,000
Cost of sales	800,000	850,000	900,000
Total costs	<u>\$950,100</u>	<u>\$1,150,100</u>	<u>\$1,350,100</u>
Net income (loss)	<u>\$120,000</u>	<u>\$(259,100)</u>	<u>\$50,000</u>

Examination of the corporate books and records reveals that the corporation purchased a fast boat for \$100,000 on 11/1/X1. It is not used for business purposes.

**7.2.6.2 Doe's Kwik Stop, Inc.**

The corporate records were obtained for this corporation. The corporate tax return shows that Doe's Kwik Stop, Inc., is a Subchapter S corporation.

## A. Balance Sheet Presentation

Description	19X1	19X2	19X3
Cash	\$20,000	\$20,000	\$310,100
Inventory	50,000	60,000	70,000
Personal property	500,000	500,000	500,000
Accumulated depreciation	50,000	200,000	350,000
Prepaid insurance	10,000	5,000	0
Organization cost	1,100	1,000	900
Total assets	<u>\$531,100</u>	<u>\$386,000</u>	<u>\$531,000</u>
Accounts payable	50,000	60,000	30,000
Shareholder loan	501,100	396,000	396,000
Stock	5,000	5,000	5,000
Retained earnings	(25,000)	(75,000)	100,000
Total	<u>\$531,100</u>	<u>\$386,000</u>	<u>\$531,000</u>

## B. Income Statement Presentation

Income	\$275,100	\$405,100	\$1,000,100
Cash expenses	100,000	150,000	400,000
Amortized insurance	0	5,000	5,000
Amortized organization	100	100	100
Depreciation	50,000	150,000	150,000
Beginning inventory	0	50,000	60,000
Purchases	200,000	160,000	280,000
Ending	50,000	60,000	70,000
Cost of sales	150,000	150,000	270,000
Total expenses	300,100	455,100	825,100
Net income (loss)	<u>\$(25,000)</u>	<u>\$(50,000)</u>	<u>\$175,000</u>

**7.2.6.3 Real Property, Ltd.**

The partnership records were obtained; they are summarized below. John Doe has a 50% partnership interest and contributed equally.

## A. Balance Sheet Presentation

Description	19X1	19X2	19X3
Cash	\$10,000	\$10,000	\$30,000
Building	10,000,000	10,000,000	10,000,000
Accumulated depreciation	250,000	750,000	1,250,000
Land	2,000,000	2,000,000	2,000,000
Total assets	11,760,000	11,255,000	10,780,000
Mortgage	7,900,000	7,500,000	7,000,000
Capital	3,860,000	3,755,000	4,890,000
Total	<u>\$11,760,000</u>	<u>\$11,255,000</u>	<u>\$10,780,000</u>

## B. Capital Account Analysis

Beginning	\$0	\$3,860,000	\$7,000,000	
Contributions		4,060,000	0	85,000
Net loss	(200,000)	(105,000)	(60,000)	
Ending balance	3,860,000	3,755,000	3,780,000	

## C. Income Statement Presentation

Rental income	\$330,000	\$1,285,000	\$1,300,000
Depreciation	250,000	500,000	500,000
Interest	200,000	750,000	700,000
Taxes	10,000	40,000	40,000
Insurance	20,000	50,000	60,000
Maintenance	50,000	50,000	60,000
Total expenses	<u>\$530,000</u>	<u>\$1,390,000</u>	<u>\$1,360,000</u>
Net loss	<u>\$200,000</u>	<u>\$105,000</u>	<u>\$60,000</u>

### 7.2.7 Bank Accounts

John Doe's bank accounts were obtained from First National Bank. The following is a summary of those accounts:

#### A. Checking Account

Date	Deposits	Withdrawals	Balance	Interest
12/31/X1	\$5,010,000	\$5,000,000	\$10,000	
12/31/X2	600,000	560,000	50,000	
12/31/X3	200,000	150,000	100,000	

#### B. Savings Account

12/31/X1	\$100,000	\$0	\$110,000	\$10,000
12/31/X2	400,000	0	550,000	40,000
12/31/X3	50,000	0	650,000	50,000

### 7.2.8 Credit Card

John Doe's credit card records were obtained. The following is a summary of this account:

Date	Charges	Payments	Balance
12/31/X1	\$30,000	\$30,000	\$0
12/31/X2	100,000	70,000	30,000
12/31/X3	180,000	160,000	50,000

All charges were for personal living expenses for both himself and his girlfriend.

### 7.2.9 Living Expenses

Various vendors' records were obtained as to John Doe's personal living expenses. They are summarized below:

Description	19X1	19X2	19X3
Utilities	\$10,000	\$10,000	\$20,000
Telephone	30,000	40,000	45,000
Insurance	5,000	10,000	10,000
Church donations	0	10,000	50,000

### 7.2.10 Automobiles

John Doe purchased a Mercedes Benz for \$80,000 in 19X1. He put \$30,000 down and financed the remainder with First National Bank. In 19X2, John Doe purchased a Toyota for \$18,000. He put \$10,000 down and financed the remainder with First National Bank. Records for both cars were obtained from the sellers. The following summarizes these transactions:

Description	19X1	19X2
Mercedes Benz	\$80,000	
Toyota		\$18,000
Financed amount	50,000	8,000
Finance charge	10,000	2,000
Monthly payments	1,000	200
Term	60 months	50 months
Paid during the year	9,000	1,200

### 7.2.11 Rental Property

Records were obtained for John Doe's rental property for 19X2. I.M. Balance, CPA, had these records in his possession. They are summarized below:

Description	19X2
Rental receipts	\$400,000
Interest expense	190,000
Property taxes	40,000
Insurance	40,000
Maintenance	20,000
Depreciation	200,000
Total expenses	<u>\$490,000</u>
Net loss	<u>\$90,000</u>

### 7.2.12 Individual Retirement Accounts

John Doe opened several Individual Retirement Accounts at First National Bank: one for Suzy Que and the other for himself. The bank records show the following:

A. For John Doe			
Year	Deposits	Interest	Balance
19X2	\$2,000	\$200	\$2,200
19X3	2,000	400	\$4,600
B. For Suzy Que			
19X2	\$2,000	\$200	\$2,200
19X3	\$2,000	400	\$4,600

### 7.2.13 Trusts

John Doe set up trust accounts for his parents, two brothers, and sister at First National Bank during 19X3.

Parents	\$100,000
Brothers (2)	100,000 each
Sister	100,000

The trust funds for the brothers are paying their college tuition and books.

### 7.2.14 Earnings

The Unemployment Bureau was contacted about the earnings of Suzy Que. The bureau provided the following data:

Date	Bank	Que Clothes	Total
19X1	\$13,000	\$0	\$13,000
19X2	14,000	50,000	54,000
19X3	15,000	70,000	85,000

### 7.2.15 Securities

John Doe purchased 100 shares of ABC stock for \$10,000 on 6/30/X2. Three months later Doe sold the stock for \$12,000. On 9/30/X2, Doe purchased 10 shares of XYZ stock for \$12,000. Two months later, he sold the XYZ stock for \$9,000.

### **7.2.16 Property Taxes**

The county tax collector's office provided records on property taxes assessed and collected from John Doe on his personal residence at 100 Alpha Street. The records show that John Doe paid \$5,000 in 19X1 and \$5,000 in 19X3. John Doe is delinquent on his property tax bill for 19X2 of \$5,000.

## **7.3 Intelligence**

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### **7.3.1 Background**

John Doe is a 24-year-old man. He dropped out of high school during his sophomore year. He held only menial jobs as a boat mechanic helper. He has not married but dates many girls on a regular basis. Even though he had no formal training in boat mechanics, he became fairly good at fixing boat engines, especially diesel engines. He was born in Cuba and came to the U.S. with his parents, two brothers, and a sister. In high school, he smoked marijuana and sold it to fellow high school students. His father is a medical doctor who worked as a laboratory technician until he became certified in this country in 19X4. His mother also worked as a laboratory technician until she got certified as a registered nurse in 19X4. His two brothers, who are older, are attending college. One brother is studying to become a civil engineer and the other is studying to become a dentist. Doe's sister is still in high school.

### **7.3.2 Commodities**

Investigators observed John Doe on 6/30/X1 going to a jewelry store with a black attaché case. He stayed in the store for about 30 minutes and came out with his attaché case. The investigators went in the store after Doe drove away. The store manager told the investigators that Doe purchased 10 bars of gold bullion for \$100,000 in cash. The store owner was very reluctant to talk about this transaction.

### **7.3.3 Offshore Mortgage**

Investigators in Panama did a check on Panama Mortgage Company. They discovered that the corporation was registered. The registered agent was a law firm. The law firm would not give any information about the corporation. The president and director of the corporation were shown on public records. When the investigators checked out the address of the president and director, they found only a vacant lot in Panama.

### **7.3.4 Offshore Bank**

A formal request was issued to Scotland Yard, London, for bank records from Barclays Bank of London. The British authorities sent the records to the U.S. An examination of these records showed that John Doe deposited cash in the British bank. The funds were later sent by wire transfer to the Panama National Bank. Banks in Panama will not give any banking information because of the bank secrecy laws.

### **7.3.5 Surveillance**

During a surveillance, it was observed that John Doe and Ramon Calderone were having dinner at the luxury club Tootie on 12/22/X0. Ramon Calderone is a well-known drug kingpin from Colombia. Calderone has been arrested five times, but the charges were always dropped because the witnesses were found floating in the Miami River.

### **7.3.6 Corporate Check**

The Bureau of Corporations shows that Real Estate, Ltd., a partnership, has only two partners, John Doe and Ramon Calderone. The Panama Mortgage Company has no registered agent in the U.S. It is not even registered to do business in any state of the U.S.

### **7.3.7 Girlfriend**

John Doe met Suzy Que on 2/28/X1 at the First National Bank, where she works as a teller. She is seen regularly with John Doe at various nightclubs, sporting events, and shopping malls. Shortly after John Doe purchased the house on 100 Alpha Street, Suzy moved in with John. She drove her own car until John purchased the Toyota for her. She drives the Toyota exclusively. Suzy continued working at the First National Bank. Friends said that she uses cocaine regularly after meeting John Doe. In 19X2 and 19X3 Suzy Que operated the Suzy's Women's Clothes business on weekends after she quit her bank teller job. Suzy hires and supervises employees. However, John Doe controls all the finances. John Doe is frequently seen at the business. When Suzy Que travels with John Doe, Betsy Low, the bookkeeper, manages the business. Betsy Low maintains all journals and ledgers and prepares a trial balance each month. John Doe never told Suzy Que about his drug trafficking activities. She only assumes that John Doe was a legitimate businessman because of all of the business activities that John Doe controlled. She has never overheard any conversations of John Doe's illegal activities.

### **7.3.8 Currency Transaction Reports**

A check of currency transaction reports reveals that First National Bank filed no reports for John Doe or any of his businesses. Also, there were no payments to Panama Mortgage Company for the mortgage on the residence by either checks, wire transfers, cashier's check, or money orders.

### **7.3.9 Wiretap**

During an authorized wiretap of Doe's residence during the last two months of 19X3, it was discovered that Doe was talking with Ramon Calderone in Colombia about a large shipment of cocaine by ship from Colombia to the Bahamas. Doe was to pick up the cocaine by his fast boat while the ship was docked in Freeport, Bahamas. Two weeks later, Doe and Suzy, along with two other couples, not identified, got on the fast boat for the weekend. U.S. Customs intercepted the boat on the way back to the U.S., but no drugs were found on the boat.

### 7.3.10 Telephone Records

The telephone toll records were obtained from the telephone company on John Doe's home telephone. These records cover the period of 1/1/X1 through 12/31/X3. They reflected the following data. Also, the telephone company provided the subscribers' information.

Telephone Number	Number of Calls	Subscriber	Country
809-XXX-XXX1	33	Residence <sup>a</sup>	Bahamas
809-XXX-XXX2	20	Barclays Bank	Cayman Islands
809-XXX-XXX3	18	Bank	Barbados
809-XXX-XXX4	6	Central Bank	Jamaica
809-XXX-XXX5	65	Central Bank	Bahamas
011-41-1-XXXXXA	2	Credit Swiss	Switzerland
011-44-1-XXXXXB	8	Barclays Bank	England
011-57-4-XXXXXC	24	R. Calderone	Colombia
011-507-XXXXXD	10	Panama Bank	Panama
011-599-8-XXXXXE	36	Panama Bank	Netherlands Antilles
011-34-3-XXXXXF	18	Residence <sup>b</sup>	Spain
011-34-3-XXXXXG	12	Central Bank	Spain

<sup>a</sup>Residence in the name of John Doe.

<sup>b</sup>Residence in the name of Ramon Calderone.

### 7.3.11 Bahamas Banks

A request to the Bahamian authorities was made as to the property in the Bahamas and for banking information from the Central Bank. They provided the following:

1. The residence in the Bahamas was purchased on 7/1/X2 for U.S.\$100,000. It is a four-bedroom, three-bath house on Blue Lagoon Cay. The house is recorded in the name of Suzy Que. There are no liens. The house has excellent dockage facilities along with a small guest house.
2. The Bahamian authorities obtained the following bank records along with other information regarding the bank account. The bank account at Central Bank is held under the name of Transshipment, Ltd. The corporate officers and directors are John Doe and Suzy Que. The corporation was formed on 6/1/X2 in Freeport, Grand Bahama. The bank account is summarized as follows:

Date	Description	Deposits	Checks	Balance
6/1/X2	Cash	\$2,000,000		\$2,000,000
6/30/X2	Cash	1,000,000		3,000,000
7/1/X2	Blue Lagoon Realty		\$110,000	2,890,000
7/10/X2	Calderone		1,500,000	1,390,000
10/1/X2	Cash	5,000,000		6,390,000
10/30/X2	Wire Calderone		2,000,000	4,390,000
3/1/X3	Cash	10,000,000		14,390,000
3/10/X3	Wire Calderone		6,000,000	8,390,000
3/31/X3	Cayman Islands		2,000,000	6,390,000
3/31/X3	Barbados		2,000,000	4,390,000
3/31/X3	Spain		1,000,000	3,390,000
3/31/X3	Switzerland		1,000,000	2,390,000
3/31/X3	Panama		500,000	1,890,000
3/31/X3	Aruba		370,000	1,520,000
3/31/X3	Bank charges		20,000	1,500,000
3/31/X3	Jamaica		1,000,000	500,000
10/1/X3	Cash	8,000,000		8,500,000
10/10/X3	Spain		4,500,000	4,000,000
12/1/X3	Panama		3,500,000	500,000



### 7.3.12 Barbados Banks

A request to the Barbados authorities was made as to the banking information from their Central Bank. The account is titled to John Doe. Suzy Que can also sign on the account. They provided the following information:

Date	Description	Deposits	Checks	Balance
3/31/X3	Bahamas	\$2,000,000		\$2,000,000
3/31/X3	Bank fees		\$10,000	1,990,000
12/31/X3	Interest	199,000		2,189,000

### 7.3.13 Spanish Banks

A formal request to the Spanish authorities was made for banking information from their Central Bank. Transshipment, Ltd., holds the account. The officer is John Doe. They provided the following:

Date	Description	Deposits	Checks	Balance
3/31/X3	Bahamas	\$1,000,000		\$1,000,000
6/30/X3	Interest	100,000		1,100,000
6/30/X3	Bank charges		\$10,000	1,090,000

The Spanish authorities also provided additional information. The Central Bank of Spain has an account for Ramon Calderone. In addition, Calderone owns a residence on the coast at Costa del Sol. Calderone paid \$2 million for the residence, which has seven bedrooms, four baths, a three-car garage, a swimming pool, and dock space for two yachts. The residence has two guest houses and quarters for eight servants.

### 7.3.14 Cayman Islands Banks

A request to the Cayman Islands authorities was made for banking information from Barclays Bank, plus any other information that they could provide. The account is titled under John Doe, with Suzy Que as a signatory on the account. They provided the following data:

Date	Description	Deposits	Checks	Balance
3/31/X3	Bahamas	\$2,000,000		\$2,000,000
6/30/X3	Interest	200,000		2,200,000
6/30/X3	Bank charges		\$20,000	2,180,000
9/30/X3	Interest	210,000		2,390,000
9/30/X3	Bank charges		20,000	2,370,000
12/31/X3	Interest	230,000		2,600,000
12/31/X3	Bank charges		20,000	2,580,000

### 7.3.15 Swiss Banks

The Swiss authorities provided the following information in response to a formal request. The account is held under Transshipment, Ltd. John Doe is shown as president.

Date	Description	Deposits	Checks	Balance
4/1/X3	Bahamas	\$1,000,000		\$1,000,000
12/10/X3	Panama	3,000,000		4,000,000
12/20/X3	Aruba		\$2,000,000	2,000,000
12/31/X3	Interest	100,000		2,100,000
12/31/X3	Bank fees		10,000	2,090,000

### 7.3.16 Aruba Banks

Authorities in Aruba provided the following data. The bank account is listed under Doe Holding NV. John Doe is shown as president, and Suzy Que as treasurer and secretary.

Date	Description	Deposits	Checks	Balance
4/4/X3	Bahamas	\$370,000		\$370,000
4/4/X3	Jamaica	100,000		470,000
4/10/X3	Schmidt Management Co.		\$20,000	450,000
6/30/X3	Bank fees		10,000	440,000
12/20/X3	Switzerland	2,000,000		2,440,000
12/31/X3	Interest	150,000		2,590,000
12/31/X3	Schmidt Management Co.		25,000	2,565,000

### 7.3.17 Jamaican Banks

The bank records from Jamaica were obtained. The account is only in John Doe's name. These records reflected the following:

Date	Description	Deposits	Checks	Balance
3/31/X3	Bahamas	\$1,000,000		\$1,000,000
4/3/X3	Aruba		\$100,000	900,000
4/3/X3	Boat repair shop		100,000	800,000
4/10/X3	Montego Hotel		20,000	780,000
4/10/X3	Gulf Oil		500	779,500
12/31/X3	Interest	7,500		787,000
12/31/X3	Bank fees		1,000	786,000

### 7.3.18 Accountant

I.M. Balance, CPA, prepares all the various tax returns for John Doe, including his corporations and partnerships. I.M. Balance did not suspect John Doe of being a drug trafficker or money launderer. John Doe periodically brings all of his various records to Mr. Balance, except for the sole proprietorship. Mr. Balance goes to Suzy's Women's Clothes store in order to perform his certified audit. He performs the entire audit tests and analysis that are required under standard audit procedures. Mr. Balance had the records for John Doe's apartment building for 19X2. He had in his possession all the records required to complete John Doe's individual tax return for 19X2, but failed to complete this return. His excuse was that he had simply forgotten to prepare the individual tax return for 19X2. Investigators had no evidence that Mr. Balance helped John Doe in laundering his illegal profits. In fact, Mr. Balance believed that John Doe was a young and successful businessman who would adhere to his advice. Doe was friendly and personable to Mr. Balance. Doe would give small gifts to Mr. Balance at Christmastime.



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# RICO Net Worth Solution

# 8



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## 8.1 General

The following solution and explanations relate to the scenario case problem presented in Chapter 7. The solution and explanations are based on Racketeer Influenced and Corrupt Organization (RICO) net worth principles in this chapter.

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## 8.2 Principles

The RICO net worth is based on the fund principle. Funds involve the use of cash, either directly or indirectly. As mentioned earlier, there is no amortization, depreciation, or depletion allowances allowed in a RICO net worth. Cash spent for asset purchases and expenses is recognized immediately. Cash spent to reduce liabilities and some income items is recognized indirectly. In the case of liabilities, the liability balance is shown instead of the payments for the liability. However, the payments can be determined by subtracting the ending balance from the beginning balance. In the case of some income, such as wages, the gross wages are shown as income and the various withholdings are shown as an expense.

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## 8.3 Problem

The following net worth schedule shows how each item in the scenario problem is presented. In addition, why they are presented in this manner is explained after the net worth schedule; the explanation section will refer to the line items on the net worth schedule.

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### 8.3.1 RICO Net Worth Schedule

The next several pages present a RICO net worth schedule. The first section of the net worth schedule is entitled assets. These are items that can be forfeited in case of conviction or civil ruling. The next section is liabilities. These are claims upon the assets by creditors. They have prior claims on these assets if secured. The liabilities are subtracted from the total assets. This will give the net worth of the subject. This net worth is compared to find the increase from one period to the next. The following section shows the business expenses from the sole proprietorship, titled business expenses. The next section is personal

expenses. This is the cost that the subject incurs in everyday living. The last section is legal income or identified income. This reflects the subject's legal sources of funds. When the personal expenses and the business expenses are added to the net worth increase, less the legal income or identified income sources, then the amount of unexplained income is derived. Under federal law, this is the amount of illegal income. The fine and forfeiture can be calculated at twice this amount.

#### **8.3.1.1 *Cash on Hand***

In this case, cash on hand is based on the currency found at John Doe's residence during the execution of the search warrant (Table 8.1, line 1). There are tax cases that say that there must be cash-on-hand figures. Cash on hand must be established as much as possible. There are various methods to determine cash on hand. One method is to check bank deposits shortly after year-end. Any cash deposits can be shown as cash on hand at year-end. Another method is to show the difference between cash deposits and checks to cash during the year. And yet another method is to use the cash-on-hand figure used on personal financial statements to creditors. If there is no cash on hand at year-end, then the investigator must present some evidence that the subject has no possible cash on hand.

#### **8.3.1.2 *Cocaine, 2 Kilos***

In this situation, the market value of cocaine is used (Table 8.1, line 2). The main reason is that no receipts will be available. However, it is well known that the subject purchased the cocaine. There were no facilities discovered that demonstrate that the cocaine was manufactured there. This means that the subject had to purchase the cocaine. Since the suspect is a subject of a drug investigation, the suspect is in the business of reselling cocaine, and thus a wholesaler. The Drug Enforcement Agency, as well as some local law enforcement agencies, keeps records of the market values of drugs on a weekly, monthly, and yearly basis, by type of drug over long periods. In a trial, an expert who keeps statistics on drug market values will have to testify on this issue.

#### **8.3.1.3 *Bank Accounts***

The bank balances are used in this schedule for the personal bank accounts, and the book balance is used for the business account (Table 8.1, lines 3 to 5). The personal bank accounts do not require a bank reconciliation schedule if the expenses, asset purchases, and liability payments are based solely on checks that clear the bank during the year. Since there are two bank accounts, a year-end confirmation should be made to see if funds from one account are transferred to the other account, or for asset purchases, liability payments, and personal expenses that will overlap years. This is not the case here. The business bank account is based on what is recorded in the books. A bank reconciliation will be needed for this bank account.

#### **8.3.1.4 *Accounts Receivable***

The accounts receivable is an asset of John Doe. Sole proprietorship assets are assets of the individual since the sole proprietor has accepted title and personal liability (Table 8.1, line 6). In criminal cases, the fraud examiner will have to confirm these accounts receivable or else have the customer testify in court that the receivable is his or her personal liability.

### **8.3.1.5 Inventory**

Inventory of the sole proprietorship is an asset of John Doe since he has title and personal liability (Table 8.1, line 7). The key problem with inventory is determining the proper quantity and costs. It is preferred that the sole proprietor's quantity and costs be used unless there is evidence that would show something different. In this case, the sole proprietor's quantity and costs are used.

### **8.3.1.6 Business Assets**

The business assets of the sole proprietorship are assets of John Doe since he has title and personal liability (Table 8.1, line 8). These assets are recorded at cost.

### **8.3.1.7 Security System**

The purchase of this asset is recorded at the purchase price paid (Table 8.1, line 9).

### **8.3.1.8 Electronic Equipment**

This asset is recorded at cost (Table 8.1, line 10).

### **8.3.1.9 Appliances**

This asset is recorded at cost (Table 8.1, line 11).

### **8.3.1.10 Fixtures**

This asset is recorded at cost (Table 8.1, line 12).

### **8.3.1.11 Furniture**

This asset is recorded at cost (Table 8.1, line 13).

### **8.3.1.12 Cabinets**

This asset is recorded at cost (Table 8.1, line 14).

### **8.3.1.13 Paintings**

This asset is recorded at cost (Table 8.1, line 15).

### **8.3.1.14 Pool and Tennis Court**

This asset is recorded at cost (Table 8.1, line 16). If the subject is making periodic payments for the construction of this asset, then a payment schedule will have to be obtained from the vendor to show the total costs. Remember, only the costs incurred for the period should be reflected on the schedule. Subsequent period costs will be added as they are incurred.

### **8.3.1.15 100 Alpha Street**

The purchase of the house is recorded at cost (Table 8.1, line 17). In this case, public records are used to determine the cost. However, the closing agent can be contacted for the closing statement, which can also be used. The best evidence rule should be followed whenever possible.

**Table 8.1 John Doe's RICO Net Worth Schedule (Title 18)**

DESCRIPTION	19X0	19X1	19X2	19X3
<i>Assets</i>				
1. Cash on hand	\$0	\$0	\$0	\$50,000
2. Cocaine, 2 kilos				50,000
3. First National Bank (FNB) checking		10,000	50,000	100,000
4. FNB savings		110,000	550,000	650,000
5. Business cash in bank			20,000	10,000
6. Accounts receivable			10,000	20,000
7. Inventory			140,000	50,000
8. Business assets			150,000	150,000
9. Security system				50,000
10. Electronic equipment			100,000	100,000
11. Appliances			20,000	20,000
12. Fixtures		10,000	10,000	10,000
13. Furniture		50,000	50,000	50,000
14. Cabinets		20,000	20,000	20,000
15. Paintings		20,000	20,000	20,000
16. Pool and tennis court		100,000	100,000	100,000
17. 100 Alpha Street		300,000	300,000	300,000
18. 100 Bravo Street		4,000,000	4,000,000	4,000,000
19. Gold bullion, 10 bars		100,000	100,000	100,000
20. Lounge Doe, Inc.		2,440,000	2,440,000	2,440,000
21. Doe Kwik Stop, Inc.		506,100	401,000	401,000
22. Real Property, Ltd.		2,030,000	2,030,000	2,072,500
23. Mercedes Benz		80,000	80,000	80,000
24. Toyota sedan			18,000	18,000
25. IRA — John Doe			2,200	4,600
26. IRA — Suzy Que			2,200	4,600
27. Bahamas residence			110,000	110,000
Total assets	0	<u>\$9,776,100</u>	<u>\$10,723,400</u>	<u>\$10,980,700</u>
<i>Liabilities</i>				
28. FNB — Mercedes loan	0	51,000	39,000	27,000
29. FNB — Toyota loan			8,800	6,400
30. Credit card			30,000	50,000
31. Accounts payable				50,000
32. Florida Mortgage Corp.		1,930,000	1,810,000	1,690,000
33. Business bank loan			100,000	80,000
Total liabilities	0	<u>\$1,981,000</u>	<u>\$1,987,800</u>	<u>\$1,903,400</u>
Net worth	\$0	<u>\$7,795,100</u>	<u>\$8,735,600</u>	<u>\$9,077,300</u>
Net worth increase		<u>\$7,795,100</u>	<u>\$940,500</u>	<u>\$341,700</u>
<i>Business Expenses</i>				
34. Purchases			180,000	130,000
35. Inventory change			(140,000)	90,000
36. Cost of sales			40,000	220,000
37. Advertising			80,000	40,000
38. Interest on loan			10,000	8,000
39. Insurance			50,000	50,000
40. Professional fees			25,000	25,000
41. Office expenses			30,000	10,000
42. Rent expense			50,000	50,000
43. Repairs			20,000	10,000
44. Supplies			30,000	10,000
45. Taxes and licenses			50,000	40,000
46. Utilities			40,000	40,000
47. Wages			120,000	150,000
48. Miscellaneous			15,000	7,000
Total business expenses		0	<u>\$560,000</u>	<u>\$660,000</u>
<i>Personal Expenses</i>				
49. Florida Mortgage interest		200,000	188,000	176,000
50. Utilities		10,000	10,000	20,000
51. Telephone		30,000	40,000	45,000

**Table 8.1 John Doe's RICO Net Worth Schedule (Title 18)**

DESCRIPTION	19X0	19X1	19X2	19X3
<i>Personal Expenses</i>				
52. Insurance		5,000	10,000	10,000
53. Life insurance		10,000		
54. Interest — car loans		10,000	2,000	
55. Income tax withheld		95,000		150,000
56. Property taxes		5,000		5,000
57. Credit card charges		30,000	100,000	180,000
58. Church donations			10,000	50,000
59. Trust funds				400,000
60. Loss —XYZ stock			3,000	
Total personal expenses		<u>\$395,000</u>	<u>\$363,000</u>	<u>\$1,036,000</u>
Total expenses		<u>\$395,000</u>	<u>\$923,000</u>	<u>\$1,696,000</u>
<i>Legal Income</i>				
61. Wages/salaries		190,000	0	200,000
62. Dividends		100,000		
63. Rental income		30,000	113,000	170,000
64. Gain — ABC stock			2,000	
65. IRA — interest Doe			200	400
66. IRA — interest Que			200	400
67. Tax refunds		500	79,250	
68. Sale — XYZ stock			9,000	
69. Business income			80,000	440,000
Total legal income		<u>\$320,500</u>	<u>\$283,650</u>	<u>\$810,800</u>
Illegal/unidentified income		7,869,600	1,579,850	1,226,900

**8.3.1.16 100 Bravo Street**

The purchase of this apartment is recorded at cost (Table 8.1, line 18). Public records are used to determine the cost. The closing statement can be obtained from the closing agent, which will show the exact cost, including any closing costs.

**8.3.1.17 Gold Bullion, 10 Bars**

The 10 gold bars are recorded at cost (Table 8.1, line 19). The market value is given at the time of seizure; if the cost was not known, then the market value would be used. Commodities, such as gold, are becoming more prevalent in money laundering. In this case, the market value is much higher than the original costs. The date of purchase is also known. If the date is not known, then the market value would be used, but only for the period discovered. If the market value and year discovered are used, then the defense would have the burden of proof to show otherwise. If the defense does present such evidence, then the costs and purchase date should be used.

**8.3.1.18 Lounge Doe, Inc.**

The net investment in this corporation is to be used (Table 8.1, line 20). This is normally a positive balance, but there are occasions when the net cash investment is negative. This can happen when the shareholder withdraws more than his investment. Corporate assets belong to the corporation and not the shareholder. In this case, the corporation has a boat that is not used in the ordinary course of business. The boat might be used in illegal activities; if so, law enforcement can seize the boat. If the shareholder is caught in illegal activities, the shareholder's stock can be forfeited. The corporation then can be dissolved



and the assets sold, or the corporation can be operated by a court-appointed trustee and later sold. Generally, the U.S. Marshal Service is responsible for seized assets.

### **8.3.1.19 *Doe Kwik Stop, Inc.***

The net investment in this corporation is to be used (Table 8.1, line 21). Its tax status has nothing to do in a RICO computation. The net investment should take into consideration capital stock, additional paid in capital, and loans from shareholders. If the corporation has loans to shareholders, then they should be subtracted from the other investment accounts.

### **8.3.1.20 *Real Property, Ltd.***

This is a partnership in which the subject has a half interest (Table 8.1, line 22). Like corporations, the net investment is used for the partner's interest only. The other partner's interest is not considered. Partnership assets belong to the partnership. If the assets of the partnership can be identified to the partner under investigation, then they can be severed from the partnership. In this case, the partners have an undivided interest in the assets, real property; therefore, it cannot be severed.

### **8.3.1.21 *Mercedes Benz***

This automobile is recorded at cost (Table 8.1, line 23). One problem that can arise with vehicles is trade-ins. The car dealer will allow a trade-in allowance for an old car against the purchase of a new car. This trade-in allowance will have to be accounted for. The cost of the old automobile should be subtracted from the trade-in allowance. This will give a profit or loss, which will have to be recognized on the net worth schedule. The purchase price will be recognized in full for the new automobile. Even though there is no cash exchanging hands, funds have been used. This is a good example of the use of funds where cash is not used.

### **8.3.1.22 *Toyota Sedan***

This automobile is recorded at cost (Table 8.1, line 24). Even though Suzy Que is driving the car, it is still charged to Doe because he paid for it. Even if the car is registered to Suzy Que's name, John Doe purchased it and should be charged for it. In essence, John Doe made a gift to Suzy Que. Another method of presentation is to show the car purchase as a gift in the expenditure section of the net worth schedule, instead of an asset of John Doe.

### **8.3.1.23 *IRA — John Doe and Suzy Que***

Individual Retirement Accounts and Keogh plans should be shown as assets (Table 8.1, lines 25 and 26). The earnings from these accounts should also be shown in the source-of-income schedule and added to the asset account.

### **8.3.1.24 *Bahamas Residence***

The cost of foreign real estate should be shown at cost (Table 8.1, line 27). If the property is acquired in other than U.S. dollars, any loss or gain on the conversion will also have to be recognized.

### **8.3.1.25 *First National Bank Car Loans***

These are two bank installment loans (Table 8.1, lines 28 and 29). Installment loans are presented as a liability. Period balances are shown at the end of each period. When these liabilities are incurred, they include both the principal and interest. For RICO net worth purposes, the interest is charged off to expense in the year incurred.

### **8.3.1.26 *Credit Card***

Balances owed on credit cards can be shown as a liability at period end (Table 8.1, line 30). The charges are shown as an expense for the period. This is an example of where the use of funds is shown indirectly. The use of funds is reflected by subtracting the liability balance from the total charges for the period. If there is a beginning liability balance, it will have to be taken into account. Another method of recognizing credit card payments is to only show the payments as an expenditure and ignore the total charges and ending liability balances.

### **8.3.1.27 *Accounts Payable***

Liabilities of a sole partnership are personal liabilities since the proprietor is personally liable. Accounts payable are claims by vendors for the business purchases (Table 8.1, line 31). In criminal cases, the fraud examiner should confirm the accounts payable, or else each vendor will have to testify as to its accounts receivable from the subject.

### **8.3.1.28 *Florida Mortgage Corp.***

Mortgage balances are shown at period end (Table 8.1, line 32). There is only one major issue to speak of in this area, and that is proper recognition of year-end balances. The determination of mortgage balances is done by subtracting the interest from the total payments. This gives the amount of principal payments, which reduce the mortgage balance. The escrow payments, if any, must be subtracted from the mortgage payments before the computation for principal payments is done.

### **8.3.1.29 *Accumulated Depreciation***

Accumulated depreciation is not used in RICO net worth computations. It must be remembered that there are no depreciation, amortization, or depletion allowances allowed in RICO net worth computations.

### **8.3.1.30 *Business Bank Loan***

Loans made to a sole proprietorship are personal liabilities. John Doe acquired a bank loan to help finance his business. This is a personal liability and is presented the same way as other personal liabilities (Table 8.1, line 33).

### **8.3.1.31 *Business Expenses***

The business expenses that are paid or accrued (if on the accrual basis of account) are to be added to the increase in net worth. These are period expenses that must be recognized during the period incurred whether paid or accrued (Table 8.1, lines 34 and 37 through 48).

### **8.3.1.32 *Inventory Changes***

This account relates to the change in inventory (Table 8.1, line 35). If inventory goes up, then this account will have a negative amount to reduce purchases (as shown on line 34). If inventory decreases, as shown for 19X3, then this account will have an increase. These increases and decreases will directly relate to the changes in inventory balances (as shown on line 7). This inventory change account has two purposes. First, it accounts for the changes in inventory. Second, it explains the composition of the cost of sales. The combination of purchases and inventory changes makes up the cost-of-sales account.

### **8.3.1.33 *Cost of Sales***

The cost-of-sales account for the sale of goods sold is composed of purchases and changes in inventory (Table 8.1, line 36). This is an expenditure for each period.

### **8.3.1.34 *Florida Mortgage Corp.***

As explained previously, this is the interest portion of the mortgage payments (Table 8.1, line 49). This is a period expense that must be recognized during the period incurred.

### **8.3.1.35 *Utilities***

This is a period expense that must be recognized during the period incurred (Table 8.1, line 50).

### **8.3.1.36 *Telephone***

This is a period expense that must be recognized during the period incurred (Table 8.1, line 51).

### **8.3.1.37 *Insurance***

This is a period expense that must be recognized during the period incurred (Table 8.1, line 52).

### **8.3.1.38 *Life Insurance***

This is a period expense that must be recognized during the period incurred (Table 8.1, line 53). This is a prepaid expense. Prepaid expenses are generally shown as assets. For RICO purposes, this is recognized as an expense in the year paid. For forfeiture purposes, this is an asset that can be seized.

### **8.3.1.39 *Interest***

This is interest paid for the two installment loans (Table 8.1, line 54). This is the total interest for the life of the loans. For RICO purposes, the interest charged is recognized during the period incurred. In this case, the interest was incurred when the loan was obtained. Even though the interest is over a period beyond the current one, it is only recognized during the period incurred. It is not capitalized and amortized; instead, it is expensed in the year incurred.

### **8.3.1.40 *Income Tax Withheld***

This is a period expense that must be recognized during the period incurred (Table 8.1, line 55). Even though there is a refund in later years, the fact that the income tax is withheld

makes it a period expense in the period incurred. Refunds will be recognized in the period received as an identified source of funds.

#### **8.3.1.41 Property Taxes**

This is a period expense that must be recognized during the period incurred (Table 8.1, line 56). In this case, the tax return figures are used. This can be admissible in a court of law, but it is advisable to get the property taxes confirmed with the local tax collector.

#### **8.3.1.42 Credit Card Charges**

This is a period expense that must be recognized in the period incurred (Table 8.1, line 57). This is a situation where the actual charges are shown as an expense. In the case of a criminal trial, the vendors will each have to testify, unless there is a stipulation, to the charges made. Otherwise, the alternative solution is to show the payments made to the credit card company, which results in no credit card liability. The problem of distinguishing between business and personal use is not an issue in this case. If a corporation pays for part or all of the personal credit card balance, then these payments should be ignored.

#### **8.3.1.43 Church Donations**

This is a period expense that is recognized in the period incurred (Table 8.1, line 58).

#### **8.3.1.44 Trust Funds**

This is a period expense that is recognized in the period incurred (Table 8.1, line 59).

#### **8.3.1.45 Loss — XYZ Stock**

This is a period expense that is recognized in the period incurred (Table 8.1, line 60).

#### **8.3.1.46 Wages/Salaries**

This is a period income item (Table 8.1, line 61). Wages and salaries are reported at the gross amounts. The various withholding items are reported as personal expenses.

#### **8.3.1.47 Dividends**

This is period income that is reported for the period earned (Table 8.1, line 62).

#### **8.3.1.48 Rental Income**

This is period income that is reported for the period earned (Table 8.1, line 63). It must be noted that these figures reflect net cash flow. Depreciation is not reflected in this net income figure. For RICO purposes, the net income that is shown on a tax return or financial statement for rental property should be adjusted by adding back any amortized and depreciation expenses. The prosecutor may want the forensic accountant to present all of the income and expenses on the net worth schedule, instead of net figures.

#### **8.3.1.49 Gain — ABC Stock**

Gains on the sale of capital assets, such as stocks, bonds, commodities, and other properties, are reported on the RICO net worth schedule (Table 8.1, line 64). Gains are computed by subtracting the original costs from the gross proceeds received. This is an identified source of receipts.

### **8.3.1.50 Sales — XYZ Stock**

The proceeds from the sale of capital assets, such as stocks, bonds, commodities, and other properties, are also reported on the RICO net worth schedule (Table 8.1, line 68), provided they are not reinvested into other assets. If they are reinvested into other assets, then the other assets will be reflected on the asset section of the net worth schedule. If they are not reinvested, then this is a source of funds that must be recognized in the source-of-funds section in the net worth schedule.

### **8.3.1.51 Tax Refunds**

This is a source of funds for the period (Table 8.1, line 67) that must be recognized. Many people file tax returns in which income tax was withheld in the prior period but a refund is due to overpayment of the tax liability. When the subject files a tax return, it is in essence a claim for the excess payment.

### **8.3.1.52 Interest**

Earnings from savings is income for the period earned and available (Table 8.1, lines 65 and 66). When interest is credited to the savings account, it is recognized in the source-of-funds section of the net worth schedule. Interest may be earned in a prior period, but if it is not credited to the account, then it is not recognized.

### **8.3.1.53 Business Income**

Gross receipts from a sole proprietorship are income to the individual owner (Table 8.1, line 69). Gross receipts are income to the proprietor regardless of whether all of them are collected when the proprietor is using the accrual method of recognizing income. This is the case here. When accruing sales income, there is a related account called accounts receivable. The accounts receivable is actually gross receipts that have not been collected. If any part of the accounts receivable is determined to be uncollectable, then it should be reduced to the collectible amount and a business expense created, called bad debts, which is the amount of uncollectable accounts receivable.

### **8.3.1.54 Illegal Income**

After adding the net worth increases and personal and business expenses, and subtracting legal or identified income, illegal income or unidentified income is derived. In presenting this case to the jury, the words *unidentified income* should be used instead of *illegal income* since the defense will object and be sustained on the grounds of leading the jury or invoking a verdict.

## **8.4 Offshore Evidence**

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The scenario problem shows many offshore transactions. You will note that these transactions are not used, with one exception. Many countries have bank secrecy laws that provide heavy criminal and civil penalties for any violations. However, certain types of records can be used if they are provided to the general public. In this case, the real property acquired in the Bahamas by John Doe is public record in the Bahamas. The U.S. Embassy or Consulate in the Bahamas can obtain certified copies of documents and present them in court. Many countries have various treaties with the U.S. Tax treaties are not in existence

with tax haven countries. However, there are many treaties with countries, including tax haven countries, that will provide information and assistance in criminal cases other than tax cases. For instance, Switzerland will provide financial information in a criminal case, i.e., drug trafficking, but will not provide financial information in a criminal tax case. Swiss authorities, like many other tax haven countries, will require that the U.S. does not use financial information for criminal tax cases even if obtained for other criminal charges. Introducing bank records or other nonpublic records from a foreign country has other problems. The principal problem is obtaining a witness from a foreign country to introduce records into court. Foreign nationals do not like to come to the U.S. and testify in a criminal case. Second, the government (federal or state) must bear the expense of bringing these foreign nationals to the U.S. In some instances, foreign nationals want fees and expenses.

## 8.5 Offshore Records

In this scenario, it will be assumed that witnesses will be obtained to introduce evidence into court. Both John Doe and Suzy Que have financial transactions offshore in various countries. If offshore evidence is obtained and properly introduced into court, then the net worth schedule will be modified as shown in Table 8.2.

**Table 8.2 RICO Net Worth Schedule Adjustment for Offshore Activities**

Description	19X1	19X2	19X3
Illegal/unidentified income	\$7,869,600	\$1,579,850	\$1,226,900
<i>Assets</i>			
70. Transshipment Ltd.:			
71. Bahamian bank account		4,390,000	500,000
72. Spanish bank account			1,090,000
73. Swiss bank account			2,090,000
74. Barbados bank account			2,189,000
75. Cayman bank account			2,580,000
76. Jamaica bank account			786,000
77. Doe Holding NV			2,565,000
Total additional assets	0	4,390,000	11,800,000
Net worth increase	0	4,390,000	7,410,000
<i>Expenses</i>			
78. Barbados bank charges	0	0	10,000
79. Cayman bank charges			60,000
80. Jamaica bank charges			1,000
81. Jamaica travel expenses			120,500
82. Wires to Calderone		3,500,000	6,000,000
83. Spanish bank charges			10,000
84. Aruba bank charges			10,000
85. Bahamas bank charges			20,000
86. Schmidt Management Co.			45,000
Total offshore expenses	0	3,500,000	6,276,500
<i>Identified Income</i>			
87. Interest income — Cayman			640,000
88. Interest income — Spain			100,000
89. Interest income — Swiss			100,000
90. Interest income — Aruba			150,000
91. Interest income — Jamaica			7,500
Total identified income	0	0	997,500
<i>Illegal/unidentified income</i>	\$7,869,600	\$9,469,850	\$13,915,900

### **8.5.1 Transshipment, Ltd.**

Transshipment, Ltd., is a Bahamian corporation. It is registered in the Bahamas and does no business in the U.S. However, it has opened up bank accounts in Spain and Switzerland, as well as in the Bahamas. One can see that this is an entity that is used for laundering illegal income, since it does not have the normal business expenses. First, it receives funds in cash, which are used to pay for drug shipments. These funds are obviously smuggled out since there are no Currency and Monetary Instrument Reports (CMIRs). Calderone is a supplier of drugs. For trial purposes, witnesses will have to be introduced that will confirm this fact. Witnesses are hard to come by since they are found deceased. The profits are transferred to other countries: Cayman Islands, Barbados, Aruba, Panama, Jamaica, and Switzerland. Transshipment, Ltd., has no financial statements or tax returns prepared. Therefore, the only financial information about this corporation is the bank balances in the various bank accounts (Table 8.2, lines 70 through 73, 82, 83, 85, 88, and 89).

### **8.5.2 Barbados Bank Account**

John Doe opened up a bank account in Barbados. He has put Suzy Que on the account by having her be a signatory on it (Table 8.2, lines 74 and 78). This is a personal bank account that can be used on the net worth schedule. However, a witness from Barbados will have to testify in court that John Doe opened and maintained the account. It is easy to see that this bank account is used for money laundering. The only expenses in it are bank charges. The only income is interest income.

### **8.5.3 Cayman Island Bank Account**

John Doe opened a bank account in the Cayman Islands (Table 8.2, lines 75, 79, and 87). These funds came from the Bahamian Bank account by wire transfer. In reality, this is an investment account since it is an interest-bearing account and no funds have been withdrawn except for service charges by the bank.

### **8.5.4 Jamaican Bank Account**

John Doe opened a bank account in Jamaica. John Doe has used this account to pay for expenses (Table 8.2, lines 76, 80, 81, and 91). It does not earn any interest, but, in fact, has paid for expenses while John Doe was in Jamaica. The vendors for those expenses would have to testify before they could be used on the net worth schedule.

### **8.5.5 Doe Holding NV**

Aruba is part of the Netherlands Antilles. It comes under Dutch control. John Doe formed this corporation along with his girlfriend, Suzy Que. Doe Holding NV is basically an entity that is used to conceal his illicit income. The only expenses are bank charges and fees for maintaining this corporation. The only asset of this corporation is the bank account (Table 8.2, lines 77, 84, 86, and 90).

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# Tax Net Worth Solution

# 9



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## 9.1 General

The following solution and explanations relate to the scenario problem presented in Chapter 7. The solution and explanations are based on tax net worth principles.

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## 9.2 Principles

The tax net worth is based on the federal income tax laws and regulations. The federal tax code defines a few concepts. One concept is gross income. Gross income means income from whatever source unless specifically exempt. Adjusted gross income is another concept. It means gross income less specified deductions. Some of these deductions are Individual Retirement Account contributions, Keogh plan contributions, alimony payments, capital losses, etc. Taxable income is another concept, which involves subtracting exemptions, itemized deductions, or standard deductions from adjusted gross income. The tax net worth schedule is based on these concepts. The first objective in a tax net worth is to establish corrected adjusted gross income, if the person filed an individual federal income tax return. After corrected adjusted gross income is determined, corrected taxable income must be determined. Some itemized deductions have limitations, which are based on adjusted gross income. Medical expenses are one example of a deduction that has limitations on the amount deductible based on the adjusted gross income.

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## 9.3 Problem

The following net worth schedule shows how each item in the scenario problem is presented. An explanation of why it is presented in the manner shown is given after the net worth schedule. The explanation section will refer to the line item on the net worth schedule.

### 9.3.1 Tax Net Worth Schedule

The next several pages present a tax net worth schedule. The first section is assets. Assets are items that have future value and can be levied against if additional tax is due. The next



section is liabilities. These are the claims by creditors against the assets. They have priority if secured. The liabilities are subtracted from the assets to derive the net worth. This is compared from one period to the next to derive increases. The next section is personal living expenses. This reflects the taxpayer's cost of living. The next section is nontaxable income. This is income derived from sources that are not taxed. When the net worth increase is added to personal living expenses, less nontaxable income, adjusted gross income is derived. To arrive at taxable income, exemptions and itemized deductions, or standard deduction, are subtracted from adjusted gross income. This corrected taxable income is compared to reported taxable income, if the taxpayer filed a return, for the net increase.

### **9.3.1.1 Cash on Hand**

Cash on hand is based on the currency found at John Doe's residence during the execution of a search warrant (Table 9.1, line 1). There are many tax cases that say that there must be cash-on-hand figures. Cash on hand must be established as precisely as possible. There are various methods to determine cash on hand. One method is to check bank deposits shortly after year-end. Any cash deposits can be shown as cash on hand at year-end. Another method is to show the difference between cash deposits and checks to cash during the year. Yet another method is to use the cash-on-hand figures used on personal financial statements to creditors. If there is no cash on hand at year-end, then the investigator must present some evidence that the taxpayer has no possible cash on hand.

### **9.3.1.2 Cocaine, 2 Kilos**

The market value of cocaine is used (Table 9.1, line 2) since no receipts will be available. There were no facilities discovered in which the cocaine was manufactured. This means that the taxpayer had to purchase the cocaine for resale. The Drug Enforcement Administration, as well as some local enforcement agencies, keep records of the market values of drugs on a weekly, monthly, and yearly basis, by type of drug over long periods. In a trial, an expert who keeps statistics on drug market values will have to testify on this issue.

### **9.3.1.3 First National Bank Accounts**

The bank balances are used in this case (Table 9.1, lines 3 and 4). No bank reconciliation schedule is required since there are two bank accounts. A year-end confirmation should be made to see if funds from one account are transferred to the other account, which will overlap years. This is not the case here.

### **9.3.1.4 Business Cash in Bank**

This bank account is based on book balances (Table 9.1, line 5). The sole proprietorship is kept on the accrual method of accounting. When books are kept on the accrual method, the book balances are used. There are various reasons. First, there are books and records kept on each transaction, which show their appropriate time of occurrence. Second, timing differences are eliminated. If a loan is made to the bank, then the book balance of the loan will be recognized instead of the bank balance, which would be higher since it received the payment in the subsequent year. Book balances will reflect proper account balances throughout the business accounts. Third, bank reconciliations will normally be available to prove

out the book balances of accounts. This applies not only to the bank account but also to related accounts, i.e., accounts receivable, accounts payable, loans, capital accounts, etc.

### **9.3.1.5 Accounts Receivable**

Even though this is a business asset, it is an asset of the individual since assets of a sole proprietorship are individually owned (Table 9.1, line 6). Accounts receivable are amounts owed to the individual by customers of the sole proprietorship. This is an intangible asset of the individual, in this case, John Doe.

### **9.3.1.6 Inventory**

This is an asset of the individual owner of the sole proprietorship (Table 9.1, line 7), and it is hard to prove out, especially if the business has many product lines. If the business takes inventory at year-end, then this inventory quantity and value should be used, especially if done by independent parties. If inventory is not taken, then the inventory value should be estimated as closely as possible to its costs. One method of doing this is the gross profit method, which uses a fairly constant cost of sales percentage based on either the business markups or industry average that will force out inventory values at year-end.

### **9.3.1.7 Business Assets**

Business assets of a sole proprietorship are assets of the individual that owns the business (Table 9.1, line 8). These assets should be recorded at cost, especially when they are recorded on the books and records at cost, which is normal for keeping business books and records. This will have a contra asset account called accumulated depreciation. This account will be addressed in Section 9.3.1.31.

### **9.3.1.8 Security System**

The purchase of this asset is recorded as the purchase price (Table 9.1, line 9).

### **9.3.1.9 Electronic Equipment**

This asset is recorded at cost (Table 9.1, line 10).

### **9.3.1.10 Appliances**

This asset is recorded at cost (Table 9.1, line 11).

### **9.3.1.11 Fixtures**

This asset is recorded at cost (Table 9.1, line 12).

### **9.3.1.12 Furniture**

This asset is recorded at cost (Table 9.1, line 13).

### **9.3.1.13 Cabinets**

This asset is recorded at cost (Table 9.1, line 14).

### **9.3.1.14 Paintings**

This asset is recorded at cost (Table 9.1, line 15).

**Table 9.1 John Doe's Tax Net Worth Schedule (Title 26)**

Description	19X0	19X1	19X2	19X3
<i>Assets</i>				
1. Cash on hand	\$0	\$0	\$0	\$50,000
2. Cocaine, 2 kilos				50,000
3. First National Bank (FNB) checking		10,000	50,000	100,000
4. FNB savings		110,000	550,000	650,000
5. Business checking			20,000	10,000
6. Accounts receivable			10,000	20,000
7. Inventory			140,000	50,000
8. Business assets			150,000	150,000
9. Security system				50,000
10. Electronic equipment			100,000	100,000
11. Appliances			20,000	20,000
12. Fixtures		10,000	10,000	10,000
13. Furniture		50,000	50,000	50,000
14. Cabinets		20,000	20,000	20,000
15. Paintings		20,000	20,000	20,000
16. Pool and tennis court		100,000	100,000	100,000
17. 100 Alpha Street		300,000	300,000	300,000
18. 100 Bravo Street		4,000,000	4,000,000	4,000,000
19. Gold bullion		100,000	100,000	100,000
20. Lounge Doe, Inc.		2,440,000	2,440,000	2,440,000
21. Doe Kwik Stop, Inc.		481,100	326,000	501,000
22. Real Property, Ltd.		1,930,000	1,877,500	1,890,000
23. Mercedes Benz		80,000	80,000	80,000
24. Toyota sedan			18,000	18,000
25. IRA — Doe			2,200	4,600
26. IRA — Que			2,200	4,600
27. Residence — Bahamas			110,000	110,000
28. Prepaid interest		8,500	8,260	5,780
Total assets	0	<u>\$9,659,600</u>	<u>\$10,504,160</u>	<u>\$10,903,980</u>
<i>Liabilities</i>				
29. FNB — Mercedes loan	0	51,000	39,000	27,000
30. FNB — Toyota loan			8,800	6,400
31. Credit card			30,000	50,000
32. Accounts payable				50,000
33. Accum. depreciation		100,000	330,000	560,000
34. Florida Mortgage Corp.		1,930,000	1,810,000	1,690,000
35. Business bank loan			100,000	80,000
Total liabilities	0	2,081,000	2,317,800	2,463,400
Net worth	0	<u>\$7,578,600</u>	<u>\$8,186,360</u>	<u>\$8,440,580</u>
Net worth increase		<u>\$7,578,600</u>	<u>\$607,760</u>	<u>\$254,220</u>
<i>Personal Living Expenses:</i>				
36. Florida Mortgage interest		200,000	188,000	176,000
37. Utilities		10,000	10,000	20,000
38. Telephone		30,000	40,000	45,000
39. Insurance		5,000	10,000	10,000
40. Life insurance				10,000
41. Interest — Mercedes loan		1,500	2,000	2,000
42. Interest — Toyota loan			240	480
43. Income tax withheld		95,000		150,000
44. Property taxes		5,000		5,000
45. Credit cards		30,000	100,000	180,000
46. Church donations			10,000	50,000
47. Trust funds				400,000
Total personal expenses		<u>\$386,500</u>	<u>\$360,240</u>	<u>\$1,038,480</u>
<i>Nontaxable Income:</i>				
48. IRA interest — Doe			2,200	2,400
49. IRA interest — Que			2,200	2,400
50. Tax refunds		500	79,250	

**Table 9.1 John Doe's Tax Net Worth Schedule (Title 26)**

Total nontaxable income	<u>\$500</u>	<u>\$83,650</u>	<u>\$4,800</u>
Adjusted gross income	\$7,964,600	\$884,350	\$1,287,900
Itemized deductions	206,500	200,240	233,480
Exemptions	2,000	2,000	2,000
Corrected taxable income	<u>\$7,756,100</u>	<u>\$682,110</u>	<u>\$1,052,420</u>
Reported taxable income	63,000	0	285,400
Increase	<u>\$7,693,100</u>	<u>\$682,110</u>	<u>\$767,020</u>

**9.3.1.15 Pool and Tennis Court**

This asset is recorded at cost (Table 9.1, line 16). If the taxpayer is making periodic payments for the construction of this asset, then a payment schedule will have to be obtained from the contractor to show the total costs. Remember, only the cost incurred during the period should be reflected on the schedule. Subsequent period costs will be added as they are incurred.

**9.3.1.16 100 Alpha Street**

The purchase of the house is recorded at cost (Table 9.1, line 17). In this case, public records are used to determine the cost. However, the closing agent can be contacted for the closing statement, which can also be used. Remember, the best evidence rule should be used when possible.

**9.3.1.17 100 Bravo Street**

The purchase of this apartment building is recorded at cost (Table 9.1, line 18). Public records are used to determine cost. The closing statement can be obtained from the closing agent, who will show the cost, including any closing costs.

**9.3.1.18 Gold Bullion Bars**

The 10 gold bars are recorded at cost (Table 9.1, line 19). The market value is given at the time of seizure; if the cost was not known, then the market value would be used. The market value is higher than the original cost in this case. If the market value and year discovered are used, then the defense would have the burden of proof to show otherwise. If the defense does present such evidence, then their costs and purchase date should be used.

**9.3.1.19 Prepaid Interest**

Installment loans have the characteristic of computing interest for the life of the loan and adding it to the principal balance. For tax purposes, the interest can only be recognized over the period of the loan (Table 9.1, line 28). This will result in a deferred expense account called prepaid interest. It is shown in the asset section of the net worth schedule. Each subsequent year, a pro rata portion is written off to the personal expenditure section. In addition, it is shown again as an itemized deduction, if deductible.

**9.3.1.20 Lounge Doe, Inc.**

The net investment in this corporation is to be used (Table 9.1, line 20). This is normally a positive balance, but there are occasions when the net cash investment can be negative.

This can happen when the shareholder withdraws more than his investment. Corporate assets belong to the corporation and not the shareholder. This corporation has a boat that is not used in the ordinary course of business. The boat might be used in illegal activities. However, the boat cannot be depreciated on the corporate books for tax purposes.

#### **9.3.1.21 *Doe Kwik Stop, Inc.***

This is a Subchapter S corporation (Table 9.1, line 21). The net worth schedule not only uses the shareholder's net cash investment, but also must take into consideration any earnings or losses the corporation has during the period. The Sub S corporation is not a taxable entity. Instead, the earnings and losses are passed on to the individual shareholders on a pro rata basis. The total net cash investment, earnings, and losses are shown on the net worth schedule, but they are never below zero.

#### **9.3.1.22 *Real Property, Ltd.***

This is a partnership in which the taxpayer has half interests (Table 9.1, line 22). Like the Sub S corporation, a partnership is a nontaxable entity. Any earnings or losses are passed to the partner based on the partner's interest. The total net cash investment, earnings, and losses are shown on the net worth schedule. They can be negative only to the extent that the partner is at risk for his share of the liabilities.

#### **9.3.1.23 *Mercedes Benz***

This automobile is recorded at cost (Table 9.1, line 23). One problem that can arise with vehicles is accounting for trade-ins. The car dealer will allow a trade-in allowance for an old car against the purchase of a new car. This trade-in allowance is used to reduce the purchase price. For tax purposes, the trade-in allowance is used to determine the gain or loss of the old car by subtracting the net basis (cost less any accumulated depreciation) from the trade-in allowance. The gain or loss on the old car will be subtracted (gains) or added (losses) to the cost of the new car. This is referred to as like-kind exchanges.

#### **9.3.1.24 *Toyota Sedan***

This automobile is recorded at cost (Table 9.1, line 24). Even though Suzy Que is driving the car, it is still charged to Doe because he paid for it. Even if the car is registered in Suzy Doe's name, if John Doe purchased it, he should be charged for it. Another method of presenting the car purchase is as a gift in the personal expenditure section of the net worth schedule, instead of an asset of John Doe.

#### **9.3.1.25 *IRA — John Doe and Suzy Que***

Individual Retirement Accounts and Keogh plans should be shown as assets (Table 9.1, lines 25 and 26). The earnings from IRAs and Keogh plans are nontaxable. One method of presentation is to show as an asset the total contributions and earnings. The earnings for the period will be reflected in the nontaxable source of income. The other method of presentation is to show as an asset the total accumulated contributions and ignore the accumulated earnings. Either method is acceptable; however, the former is preferred since it shows the actual funds in the account.

### **9.3.1.26 Bahamas Residence**

The cost of foreign real estate should be shown at cost (Table 9.1, line 27). If the property is acquired in other than U.S. currency, then a conversion will have to be made to U.S. dollars. Any loss or gain on the conversion will also have to be recognized. Since this would be an adjustment to gross income, it would not be recognized on the tax net worth schedule.

### **9.3.1.27 First National Bank Auto Loans**

There are two bank installment loans (Table 9.1, lines 29 and 30). Installment loans are presented as a liability. Period balances are shown at the end of each period. When these liabilities are incurred, they include both the principal and interest.

### **9.3.1.28 Credit Card**

Balances owed on credit cards can be shown as liabilities at period end (Table 9.1, line 31). The charges are shown as personal expenditures for the period. Another way of presenting credit cards is to only show the amount paid to the credit card company as a personal expenditure. Either method can be used, but they must be used consistently.

### **9.3.1.29 Accounts Payable**

Accounts payable are liabilities of the sole proprietor (Table 9.1, line 32). Liabilities of a sole proprietor are liabilities of the individual since the individual is personally liable.

### **9.3.1.30 Florida Mortgage Corp.**

Mortgage balances are shown at period end (Table 9.1, line 34). The mortgage payments include principal and interest. In many cases, mortgage payments also include escrow payments to cover property taxes and insurance. If this is the case, a corresponding asset for escrow balances will have to be reflected on the net worth schedule.

### **9.3.1.31 Accumulated Depreciation**

Accumulated depreciation balances have to be shown on the net worth schedule (Table 9.1, line 33) on the grounds that they are potential liabilities. The federal tax laws and regulations require the recovery of accumulated depreciation as ordinary taxable income to the extent of any gain recognized on the sale of the depreciable asset.

### **9.3.1.32 Business Bank Loan**

Loans from financial institutions by a sole proprietor are individual loans (Table 9.1, line 35). The individual is personally liable for the business bank loan; therefore, it is a personal liability.

### **9.3.1.33 Florida Mortgage Corp. Interest**

This is the interest portion of the mortgage payments (Table 9.1, line 36). This is shown as both a personal expenditure and an itemized deduction.

### **9.3.1.34 Utilities**

This is a period expense that must be recognized during the period paid as a personal expenditure (Table 9.1, line 37).

**9.3.1.35 Telephone**

This is a period expense that must be recognized during the period paid as a personal expenditure (Table 9.1, line 38).

**9.3.1.36 Insurance**

This is a period expense that must be recognized during the period paid (Table 9.1, line 39). It must be kept in mind that medical insurance premiums can also be deducted as an itemized deduction.

**9.3.1.37 Life Insurance**

Life insurance is normally a period expense (Table 9.1, line 40). However, in the case of whole life policies that have surrender or cash values, life insurance policies should reflect the cash value as an asset and the noncash value as an expense. This solution treats the whole life policy as an expense.

**9.3.1.38 Interest Amortized**

This is the pro rata portion of the prepaid interest (Table 9.1, lines 41 and 42). This is shown as a current period expense. In addition, it can be used as an itemized deduction.

**9.3.1.39 Income Tax Withheld**

This is a period expense (Table 9.1, line 43). Even though this is a personal expenditure, there will not be any payments found for this expense in the taxpayer's possession. The employer pays this expense out of the taxpayer's gross wages and salaries. In addition to the income tax withholding, FICA tax (Social Security contributions) is also withheld and should be reflected as a personal expense. The FICA tax was not presented in this problem.

**9.3.1.40 Property Tax**

This is a period expense (Table 9.1, line 44). Property taxes must be recognized only in the period when paid. Sometimes taxpayers will pay their property taxes for 2 years in 1 year.

**9.3.1.41 Credit Card Charges**

This is a period expense (Table 9.1, line 45). This presentation shows the total charges made during the period. It does not show the payments to the credit card company. For trial purposes, the vendors who accepted the credit card charges will have to introduce these into court. The alternative method is to introduce the credit card record custodian as to the payments received from the taxpayer. A problem can arise if any of the charges made were for business expenses. If this is the case, then they will have to be subtracted from the total charges or the total of the payments.

**9.3.1.42 Church Donations**

This is a period expense (Table 9.1, line 46). In addition to being shown on the personal expenditure section, it is used as an itemized deduction.

### 9.3.1.43 *Trust Funds*

This is a period expense (Table 9.1, line 47). The key question in this situation is whether the trust is a viable instrument. Sometimes trusts are set up to cover up a taxpayer's own funds. If this is the case, then the trust fund should be shown as the taxpayer's asset.

### 9.3.1.44 *Loss — XYZ Stock*

This is a period expense. For tax purposes, losses on stock are not recognized since this is a capital asset. Losses on sales of capital assets are not recognized on the net worth computation. The main reason is that this is an adjustment to derive adjusted gross income. The purpose of the tax net worth schedule is to derive adjusted gross income, and not gross income. Therefore, it is not shown on the tax net worth schedule.

### 9.3.1.45 *IRA Interest*

The interest earned on Individual Retirement Accounts and Keogh plans is not taxable (Table 9.1, lines 48 and 49). As explained previously, if these accounts are shown in the asset section with both earnings and contributions, then the interest earned for the period will have to be shown as a nontaxable source of income.

### 9.3.1.46 *Tax Refunds*

Tax refunds are nontaxable sources (Table 9.1, line 50). This net worth schedule reflects the total taxes paid as a personal expenditure, and refunds as a source of nontaxable income. However, it can be shown at net. It is better to show it separately in order to disclose both.

### 9.3.1.47 *Itemized Deductions*

Itemized deductions or the standard deduction are allowed to reduce adjusted gross income to derive taxable income. The federal income tax code allows certain expenses to be deducted. The primary ones are medical expenses, interest expenses, charity contributions, certain taxes, and some other miscellaneous expenses. In this solution, itemized deductions are the total personal expenditures for interest (mortgage and amortized interest), church donations, and property taxes. Limitations on these deductions, which are built in the tax code, have been ignored in this problem. The itemized deductions are delineated below:

Description	19X1	19X2	19X3
Florida Mortgage interest	\$200,000	\$188,000	\$176,000
Interest — Mercedes	1,500	2,000	2,000
Interest — Toyota		240	480
Property taxes	5,000		5,000
Church donations		10,000	50,000
Total	<u>\$206,500</u>	<u>\$100,240</u>	<u>\$233,480</u>

### 9.3.1.48 *Exemptions*

Exemptions are an income tax concept. The amount of these exemptions varies from year to year. For the sake of simplicity, \$2,000 per exemption is used in this case.

## 9.4 Offshore Evidence

The scenario problem has many offshore assets and transactions. These assets and transactions cannot be used on the net worth schedule unless witnesses are available to introduce



them into court. There are exceptions. One is the introduction of public records from a particular country. In this case, the Bahamas real property is public record and can be introduced into court. The U.S. Embassy or Consulate in the Bahamas can obtain certified copies of documents and present them into court records. Bank records cannot be introduced into court since many countries have bank secrecy laws, which provide heavy criminal and civil penalties for any violations. Also, many tax haven countries will not allow bank records for criminal or civil tax trials in the U.S. Another problem of introducing nonpublic records is obtaining a witness from a foreign country. Foreign nationals do not like to come to the U.S. to testify in a criminal case. The government (federal and state) must bear the expense of bringing these foreign nationals to the U.S.

## 9.5 Offshore Records

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Now it will be assumed that witnesses will be obtained to introduce evidence into court. John Doe and Suzy Que have assets and financial transactions in various countries. If the offshore evidence is properly obtained and introduced into court, then the net worth schedule will be modified as shown in Table 9.2.

### 9.5.1 Bank Accounts

These are assets of John Doe (Table 9.2, lines 54 through 56). Bank balances are used instead of book balances. These accounts are in three different countries, two of which are tax haven countries. In tax cases, tax haven officials, whether bank or government, will not cooperate. However, these records can be used if found during a search. The Jamaican bank account was used to pay expenses while in that country. The other two accounts were used only to park his illegal gains. In all probability, the government will not be able to seize these funds. The corporate bank accounts are also assets of John Doe.

### 9.5.2 Bank Charges

These are period expenses (Table 9.2, lines 58 through 60). Record custodians will have to introduce these records into trial court, unless the defense will stipulate. This can be a problem if the foreign witnesses refuse to come. Another problem area is the conversion of foreign currency into U.S. currency. Bank charges on corporate accounts are not shown since these would be corporate expenses. However, they could be shown in this case based on the fact that these corporations are only shells. Assets of shell corporations are in reality assets of the individual, which are being concealed by corporate identity.

### 9.5.3 Jamaica Travel

This is a period expense (Table 9.2, line 61). This could be classified as either a vacation trip or a business trip. A vacation trip is a personal expense and should be reflected on the net worth schedule. If this is a business trip, then it is not reflected on the net worth schedule if it is part of a sole proprietorship. As an employee or officer of a corporation, it can be classified as a personal expense, but later on can be deducted as an itemized deduction with limitations. However, if the business trip is to facilitate drug trafficking activities, then this is not an allowable business expense per the federal income tax code. Thus, it then becomes a personal expense.

**Table 9.2 John Doe's Tax Net Worth Adjustments for Offshore Activities (Title 26)**

Description	19X1	19X2	19X3
<i>Assets</i>			
Transshipment, Ltd.:			
51. Bahamian bank account	\$0	\$4,390,000	\$500,000
52. Spanish bank account			1,090,000
53. Swiss bank account			2,090,000
<i>Personal accounts:</i>			
54. Barbados bank account			2,189,000
55. Cayman bank account			2,580,000
56. Jamaica bank account			786,000
57. Doe Holding NV bank account			2,565,000
Total additional assets	0	<u>\$4,390,000</u>	<u>\$11,800,000</u>
Net worth increase	0	<u>\$4,390,000</u>	<u>\$7,410,000</u>
<i>Expenses</i>			
58. Barbados bank charges			10,000
59. Cayman bank charges			60,000
60. Jamaica bank charges			1,000
61. Jamaica travel expenses			120,500
Total expenses	0	0	191,500
Previous corrected income	\$7,756,100	\$682,110	\$1,052,420
Corrected taxable income	7,756,100	5,072,110	8,653,920
Reported taxable income	63,000	0	285,400
Increase	<u>\$7,693,100</u>	<u>\$5,072,110</u>	<u>\$8,368,520</u>

#### 9.5.4 Transshipment, Ltd., Bank Accounts

Transshipment, Ltd., is a Bahamian corporation. Since corporate books and records were not kept, the bank accounts are assets of the corporation, as well as the capital, which is the shareholder's equity. The corporation does not do any business; therefore, it is a shell corporation. Transshipment, Ltd., has bank accounts in three foreign countries (Table 9.2, lines 51 through 53).

#### 9.5.5 Doe Holding NV

Aruba is part of the Netherlands Antilles, which is under Dutch control. Doe Holding NV is a Netherlands Antilles corporation that was formed by John Doe and Suzy Que. The only asset of this corporation is the bank account (Table 9.2, line 57). The corporation has no business activities. The funds are capital contributions by John Doe. This is a shell corporation.





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## 10.1 General

The following solution and explanations relate to the scenario problem presented in Chapter 7. The solution and explanations are based on the Racketeer Influenced and Corrupt Organization (RICO) expenditure principles.

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## 10.2 Principles

The RICO expenditure method is based on the fund principle. Funds involve the use of cash either directly or indirectly. There are no amortization, depreciation, or depletion allowances allowed on a RICO expenditure schedule. Unlike the RICO net worth method, the RICO expenditure method, by its nature, shows the use of funds more directly than indirectly. It is also easier to explain to a jury of laymen. One disadvantage of the expenditure method is that it does not list the accumulated assets and liabilities. Assets are only reflected when they are purchased. Liabilities are only shown when they are acquired. It also only shows the amount of payment on liabilities, and not the balances.

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## 10.3 Problem

The following expenditure schedule shows how each item in the scenario problem is presented. An explanation follows the expenditure schedule of why the item is presented in this manner. The explanation section will refer to the line item on the expenditure schedule.

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### 10.3.1 RICO Expenditure Schedule

The following presents a RICO expenditure schedule. The first section deals with the expenditure side. The second section deals with the identified or legal source of income. The difference between the total expenditures and the total sources of identified receipts gives the amount of income derived from unidentified sources. Whether the expenditure method or the net worth method is used, the bottom line should be the same. An expenditure schedule can be converted to a net worth schedule and vice versa.

**Table 10.1 John Doe's RICO Expenditure Schedule (Title 18)**

Description	19X1	19X2	19X3
<i>Asset Purchases</i>			
1. Cash on hand	\$0	\$0	\$50,000
2. Cocaine, 2 kilos			50,000
3. Gold bullion, 10 bars	100,000		
4. First National Bank (FNB) — checking	10,000	40,000	50,000
5. FNB — savings	110,000	440,000	100,000
6. Business cash in bank		20,000	(10,000)
7. Accounts receivable		10,000	10,000
8. Inventory		140,000	(90,000)
9. Business assets		150,000	
10. 100 Alpha Street	300,000		
11. 100 Bravo Street	4,000,000		
12. Furniture	50,000		
13. Cabinets	20,000		
14. Paintings	20,000		
15. Fixtures	10,000		
16. Pool and tennis court	100,000		
17. Appliances		20,000	
18. Electronic equipment		100,000	
19. Security system			50,000
20. Lounge Doe, Inc.	2,440,000		
21. Doe Kwik Stop, Inc.	506,100	(105,100)	
22. Real Property, Ltd.	2,030,000	42,500	
23. Mercedes Benz	80,000		
24. Toyota sedan		18,000	
25. IRA — John Doe		2,200	2,400
26. IRA — Suzy Que		2,200	2,400
27. Bahamas residence		110,000	
Total asset purchases	<u>\$9,776,100</u>	<u>\$947,300</u>	<u>\$257,300</u>
<i>Acquired Liabilities</i>			
28. Florida Mortgage Corp.	\$70,000	\$120,000	\$120,000
29. Loan — Mercedes	9,000	12,000	12,000
30. Loan — Toyota		1,200	2,400
31. Business bank loan			20,000
Total acquired liabilities	<u>\$79,000</u>	<u>\$133,200</u>	<u>\$154,400</u>
<i>Business Expenses</i>			
32. Inventory purchases		\$180,000	\$130,000
33. Inventory changes		(140,000)	90,000
Total business expenses	0	<u>\$40,000</u>	<u>\$220,000</u>
<i>Business Expenses</i>			
34. Advertising		80,000	40,000
35. Interest — bank loan		10,000	8,000
36. Insurance		50,000	50,000
37. Professional fees		25,000	25,000
38. Office expenses		30,000	10,000
39. Rent expense		50,000	50,000
40. Repairs		20,000	10,000
41. Supplies		30,000	10,000
42. Taxes		50,000	40,000
43. Utilities		40,000	40,000
44. Wages/salaries		120,000	150,000
45. Miscellaneous		15,000	7,000
Total business expenses	0	<u>\$520,000</u>	<u>\$440,000</u>
<i>Personal Expenses</i>			
46. Florida Mortgage Corp. interest	\$200,000	\$188,000	\$176,000
47. Life insurance	10,000		
48. Income tax withheld	95,000		150,000
49. Property taxes	5,000		5,000
50. Credit card charges	30,000	70,000	160,000
51. Utilities	10,000	10,000	20,000

**Table 10.1 John Doe's RICO Expenditure Schedule (Title 18)**

52. Telephone	30,000	40,000	45,000
53. Insurance	5,000	10,000	10,000
54. Church donations		10,000	50,000
55. Interest — Mercedes	10,000		
56. Interest — Toyota		2,000	
57. Trust funds			400,000
58. Loss — XYZ stock		3,000	
Total personal expenses	<u>\$395,000</u>	<u>\$333,000</u>	<u>\$1,016,000</u>
Identified Receipts			
59. Florida Mortgage Corp.	2,000,000		
60. Loans — autos	60,000	10,000	
61. Accounts payable			50,000
62. Income tax refunds	500	79,250	
63. IRA interest — Doe		200	400
64. IRA interest — Que		200	400
65. Dividends	100,000		
66. Wages/salaries	190,000		200,000
67. Rental income	30,000	113,000	170,000
68. Gain — ABC stock		2,000	
69. Sales — XYZ stock		9,000	
70. Business income		80,000	440,000
71. Business bank loan		100,000	
Total receipts	<u>\$2,380,500</u>	<u>\$393,650</u>	<u>\$860,800</u>
<i>Illegal/unidentified income</i>	<u>\$7,869,600</u>	<u>\$1,579,850</u>	<u>\$1,226,900</u>

### 10.3.1.1 Cash on Hand

Cash on hand is based on the currency found at John Doe's residence during the execution of the search warrant (Table 10.1, line 1). Cash on hand should be established as much as possible for each period. Cash on hand should show the addition to or decrease of funds for the period, and not the ending balance.

### 10.3.1.2 Cocaine

The market value of cocaine is used in this solution (Table 10.1, line 2). This is a situation where market values are used; the primary reason is that receipts will not be available. It is well known that the subject purchased the cocaine. There were no facilities discovered in which the cocaine was manufactured. This implies or suggests that the subject purchased the cocaine. The Drug Enforcement Agency and other local law enforcement agencies keep statistics on the market values of drugs, both retail and wholesale, on a regular basis.

### 10.3.1.3 Gold Bullion

The 10 gold bars are recorded at cost (Table 10.1, line 3). The market value at the time of the search warrant is higher than the original cost. If the cost and date of purchase are not known, then the market value and time of discovery can be used. If market value is used, then the burden of proof is placed upon the defense to establish cost and date of purchase.

### 10.3.1.4 Cash in Banks

Increases or decreases in bank balances are reflected in this schedule (Table 10.1, lines 4 to 6). The increase or decrease in bank balances can be based on either the book changes or the bank changes. Whatever method is used, it must be used consistently for each bank account. It is suggested that a better way of presenting the changes in bank balances is to

show the ending balance on the expenditure schedule and subtract the beginning balance. First, it shows the jury where and how the figures were obtained. Second, it helps confirm the change computations. In this case, the personal bank accounts use the bank balances, while the business account is based on book balances. The business bank account is kept and reconciled on a monthly basis and is used for keeping the cash receipts and disbursement journals. Also, the sole proprietorship uses the accrual method of accounting, while the personal expenses and receipts are based on the cash method of accounting.

#### **10.3.1.5 Accounts Receivable**

Accounts receivable from a sole proprietorship are a personal asset of the individual owner (Table 10.1, line 7). The expenditure method requires only that changes be reflected on the expenditure schedule. A suggested way of presenting the changes in accounts receivable balances is to show the ending balance on the expenditure schedule and subtract the beginning balance. It shows the jury from where and how the figures were obtained by relating them to the financial statements or tax returns that are introduced into evidence.

#### **10.3.1.6 Inventory**

Inventory from a sole proprietorship is a personal asset of the individual owner (Table 10.1, line 8). The expenditure method requires only that changes be reflected on the expenditure schedule. This also can be presented by showing the ending balances less the beginning balances, so the jury can understand how the figures were derived.

#### **10.3.1.7 Business Assets**

The purchase of assets for use in the business of a sole proprietorship is considered assets of the individual owner (Table 10.1, line 9). Business assets are recorded at cost for the period purchased.

#### **10.3.1.8 100 Alpha Street**

The purchase of the house is recorded at cost (Table 10.1, line 10). In this case, public records are used to determine the cost. However, the closing statement from the closing agent can be used, which would also show additional closing costs. The best evidence rule requires the original documents to be produced, instead of copies.

#### **10.3.1.9 100 Bravo Street**

The purchase of the apartment building is recorded at cost (Table 10.1, line 11). Public records are used to determine the cost. The closing statement can also be used, which would show additional closing costs charged by the closing agent.

#### **10.3.1.10 Furniture**

Furniture is recorded at cost for the period purchased (Table 10.1, line 12).

#### **10.3.1.11 Cabinets**

Cabinets are recorded at cost for the period purchased (Table 10.1, line 13).

#### **10.3.1.12 Paintings**

Paintings are recorded at cost for the period purchased (Table 10.1, line 14).

**10.3.1.13 Fixtures**

Fixtures are recorded at cost for the period purchased (Table 10.1, line 15).

**10.3.1.14 Pool and Tennis Court**

These assets are recorded at cost for the period purchased (Table 10.1, line 16). If there were subsequent purchases or additional costs, these costs would be shown for the period incurred, and not the accumulated balances.

**10.3.1.15 Appliances**

Appliances are recorded at cost for the period purchased (Table 10.1, line 17).

**10.3.1.16 Electronic Equipment**

These assets are recorded at cost for the period purchased (Table 10.1, line 18).

**10.3.1.17 Security System**

This asset is recorded at cost for the period purchased (Table 10.1, line 19).

**10.3.1.18 Lounge Doe, Inc.**

This investment is recorded at the net cash investment for the period (Table 10.1, line 20). This can be either a positive or negative change. A negative change means the subject withdrew more funds than what was invested into the corporation. The boat is a corporate asset, and not a shareholder asset.

**10.3.1.19 Doe Kwik Stop, Inc.**

Investment in this corporation is recorded at the net cash investment for the period (Table 10.1, line 21). Its tax status has nothing to do with a RICO investigation. The net investment, like any other corporation, should take into consideration capital stock, additional paid in surplus, and loans from and to shareholders. If the corporation has made any loans during the period to the shareholder, then they should be subtracted from the other investment accounts.

**10.3.1.20 Real Property, Ltd.**

Investment into this partnership by the partner is recorded at the net cash investment (Table 10.1, line 22). The partner's shares of liabilities are not considered in this computation. The other partner's interest is not considered. Partnership assets belong to the partnership and not the partners. If the partner's assets can be identified separately from the other partner's, then they can be severed for forfeiture purposes, but not for expenditure method purposes. In this case, the partners have an undivided interest in the assets, specifically real property. The partner's interest cannot be severed in this situation. Another problem arises when one partner either contributes or withdraws assets out of proportion with his partnership interest. These out-of-proportion contributions or withdrawals should be reflected in the expenditure schedule.

**10.3.1.21 Mercedes Benz**

This car is recorded at cost during the period purchased (Table 10.1, line 23). A problem can arise if another car was traded in for this one. In the same manner as in the net worth



method, the trade-in allowance will have to be accounted for. In essence, the gain or loss on the old car will increase or decrease the cost of the new car.

#### **10.3.1.22 *Toyota Sedan***

This vehicle is recorded at cost during the period purchased (Table 10.1, line 24). The car is charged to John Doe if he paid for it. This vehicle can be shown either as a gift or as an asset purchase.

#### **10.3.1.23 *Individual Retirement Accounts***

Contributions to Individual Retirement Accounts and Keogh plans should be shown for the period (Table 10.1, lines 25 and 26). These accounts will also have earnings for the period. There are two ways of presenting these accounts on the expenditure schedule: one is to show the contributions only and ignore the earnings altogether; the other is to show the contributions plus the earnings. The earnings would be reflected as a source of income for the period.

#### **10.3.1.24 *Bahamas Residence***

This asset should be shown at cost for the period acquired (Table 10.1, line 27). One problem involved in this case is the possible conversion from a foreign currency to U.S. currency. Any gain or loss on the conversion will have to be recognized. In this case, the Bahamas accepts U.S. currency as well as its own currency in its everyday economy. Thus, no conversion is necessary in this case.

#### **10.3.1.25 *Florida Mortgage Corp.***

The payments to the mortgage company should be shown as an application of funds. Mortgage payments usually include principal and interest. Many times, escrow payments are included to cover property taxes and insurance. A breakdown of these payments will have to be made as to both principal and interest. If escrow payments are included in the mortgage payments, then a breakdown of these payments will also have to be made. The breakdown of the mortgage payments can be done on a supporting schedule. Any closing costs should be expensed for the period. The proceeds from a mortgage should be shown on the expenditure schedule as a source of funds (Table 10.1, line 59).

#### **10.3.1.26 *Installment Loans***

The proceeds from installment loans should be shown as a source of funds for the period obtained (Table 10.1, lines 29 and 30). The payments to these installment loans should be reflected as an application of funds (Table 10.1, line 60). A problem arises when the bank adds the interest to the principal balance. The interest is for the whole period of the loan, which normally extends beyond the current period. In this situation, the interest is recognized at the same period the loan proceeds are recognized. This interest is not capitalized and later amortized. It is expensed in the period the loan was incurred.

#### **10.3.1.27 *Business Bank Loan***

Payments on a loan are classified as expenditure of funds (Table 10.1, line 31). This is a business loan from Doe's sole proprietorship. Loans from a sole proprietorship are personal loans since the sole proprietor is solely liable for the loan. Receipts from a loan are sources

of funds (Table 10, line 71). Business loan payments include both principal and interest, and one must separate the interest from the principal.

#### **10.3.1.28 Purchases**

The purchases of inventory for a sole proprietorship are expenditures by the individual owner (Table 10.1, line 32). These expenditures are classified as personal even though they are for resale in a business. Assets of a sole proprietorship, whether used personally or for resale, belong to the individual.

#### **10.3.1.29 Inventory Change**

This account is used to show the changes in inventory, as it affects the cost of sales (Table 10.1, line 33). The total purchases plus or minus the changes in inventory compose the total cost of sales of inventory that is sold. When inventory increases, the inventory change account decreases because part of the purchases have not been sold. When the inventory decreases, the inventory change account increases because part of the inventory has been sold in addition to the purchases that have been made during the period.

#### **10.3.1.30 Business Expenses**

The expenses of operating a sole proprietorship are considered personal expenditures (Table 10.1, lines 34 through 45). When the sole proprietorship uses the accrual method of accounting, all business expenses are recognized when incurred, regardless of whether they have been paid. Any outstanding liabilities will be recognized as a source of funds. This will offset the expenses that are not paid.

#### **10.3.1.31 Mortgage Interest**

This is the interest portion of the mortgage payments to Florida Mortgage Corp. (Table 10.1, line 46) that were paid during the period.

#### **10.3.1.32 Life Insurance**

This is an expense during the period incurred (Table 10.1, line 47). This expenditure is recognized during the period paid. It is not amortized over the period for which the premium covers.

#### **10.3.1.33 Tax Withholdings**

This is a period expenditure (Table 10.1, line 48). Even though a refund is made in later years, withholding is recognized during the period incurred. The employer pays withholding during the year from the employee's salaries and wages. Thus, it is a personal expenditure even though it was not paid directly by the employee.

#### **10.3.1.34 Property Taxes**

This is an expense for the periods involved (Table 10.1, line 49). It should be kept in mind that expenditures are recognized during the period paid and not when incurred.

#### **10.3.1.35 Credit Card Charges**

This is an expense for the periods involved (Table 10.1, line 50). This case shows only the amount of funds paid to the credit card company and not the charges made against it. The expenditure method normally uses the payments to the credit card company instead

of the charges. The expenditure method can use credit card charges, but this is offset in the source of funds by the change in the liability to the credit card companies.

#### **10.3.1.36 Utilities**

This is an expense for the period involved (Table 10.1, line 51).

#### **10.3.1.37 Telephone**

This is an expense for the period incurred (Table 10.1, line 52).

#### **10.3.1.38 Insurance**

This is an expense for the periods involved (Table 10.1, line 53).

#### **10.3.1.39 Church Donations**

This is an expenditure for the period involved (Table 10.1, line 54).

#### **10.3.1.40 Installment Loan Interest**

This is an expense for the period incurred (Table 10.1, lines 55 and 56). It is not capitalized and amortized over the term of the loan. It is expensed during the year the loans were incurred. The interest relates to an installment loan where the bank charges interest for the term of the loan and adds it to the principal borrowed.

#### **10.3.1.41 Trust Funds**

This is an expenditure for the period involved (Table 10.1, line 57). Trusts should be examined closely because there may be funds set aside for the contributor. In this case, the trust funds are set aside for the benefit of the subject's relatives and not the subject.

#### **10.3.1.42 Stock Losses**

This is an expense for the period (Table 10.1, line 58). Losses on the sale of assets are recognized as an expenditure during the period in which the loss was incurred.

#### **10.3.1.43 Accounts Payable**

Accounts payable are personal liabilities of the sole proprietor (Table 10.1, line 61). The purpose of these accounts are to offset the purchases of goods and services that have not been paid. These remaining liabilities are actually a source of funds for goods and services that are not paid for the sole proprietorship. The sole proprietor is the subject of investigation. The expenditure schedule should show the change in the liabilities and not the balance.

#### **10.3.1.44 Income Tax Refunds**

This is a source of funds during the period received (Table 10.1, line 62).

#### **10.3.1.45 IRA Interest**

This is a source of funds for the period when credited to the accounts (Table 10.1, lines 63 and 64). Also, the earnings should show up as an application to the contributions made for the period.

**10.3.1.46 Dividends**

Corporate distributions, called dividends, should be recognized during the period received (Table 10.1, line 65).

**10.3.1.47 Wages/Salaries**

Earnings from employment should be recognized when received or reported for the period received or declared (Table 10.1, line 66). Any withholding should be recorded as an expenditure for the period paid or reported.

**10.3.1.48 Rental Income**

Earnings from rental income are solely based on the net funds either received or paid for the period (Table 10.1, line 67). Any phantom figures are to be removed from the earnings or losses shown on the appropriate financial statements. Rental income should be shown only as the net cash flow from earnings. Any asset payments or liability reductions will be reflected on the expenditure schedule for those respective line items.

**10.3.1.49 Stock Gains**

Gains from the sale of capital assets will be shown on the expenditure schedule as a source of funds (Table 10.1, line 68), even if the gains are reinvested into other capital assets.

**10.3.1.50 Stock Sales**

The sale of XYZ stock is the proceeds, which recovers the original cost (Table 10.1, line 69). Any gains or losses will be recognized separately. If the proceeds from the sales were reinvested into other capital assets, then this recovery of cost would not be recognized as a source of funds. The application side would show the purchase of other assets.

**10.3.1.51 Business Income**

This is the gross receipts of the sale of goods and services from a sole proprietorship (Table 10.1, line 70). Income from a sole proprietorship is income to the individual. This sole proprietorship's income is based on the accrual method of accounting. As shown above, the sole proprietor has accounts receivable. Accounts receivable are the amount of gross receipts at year-end that have not been collected.

**10.4 Offshore Evidence**

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The scenario problem shows many offshore assets and financial transactions. Offshore transactions are generally not admissible in court. However, there are some exceptions. Public records in foreign countries are admissible when properly certified. The Bahamas residence in this case is one example. Land transfer records are open to the public in the Bahamas, as well as many other countries. Bank records are not public, and in many countries improper disclosure can result in criminal and civil actions. Some tax haven countries' bank records are not allowed in criminal or civil tax cases; however, by treaty agreements, other countries will provide bank records in other criminal cases, i.e., racketeering, drug trafficking, and other criminal activities. One major problem in admitting foreign, nonpublic records is obtaining witnesses to introduce them into court. Government budgets may not allow the travel expenses of the witnesses. Many foreign nationals

do not like to testify in court, especially if they feel they can be charged for aiding and abetting.

## 10.5 Offshore Records

It is now assumed that witnesses will be obtained to introduce evidence into court. This offshore evidence, as you will see, has a material effect on the expenditure method. The RICO expenditure schedule would be modified as shown in Table 10.2.

### 10.5.1 Assets

The assets consist primarily of changes in the various offshore bank accounts (Table 10.2, lines 72 through 79). In 19X3, the bank account in the Bahamas under the alter ego of Transshipment, Ltd., had a decrease in the account. This is a source of funds, thus the negative amount. The other accounts, whether under a corporate name or individual, show an increase in the accounts, thus an application of funds.

**Table 10.2 John Doe's RICO Expenditure Schedule Adjustments with Offshore Activities (Title 18)**

Description	19X1	19X2	19X3
Illegal/unidentified income	\$7,869,600	\$1,579,850	\$1,226,900
<i>Assets</i>			
72. Transshipment, Ltd.			
73. Bahamian bank account		4,390,000	(3,890,000)
74. Spanish bank account			1,090,000
75. Swiss bank account			2,090,000
76. Barbados bank account			2,189,000
77. Cayman bank account			2,580,000
78. Jamaica bank account			786,000
79. Doe Holding NV			2,565,000
Total additional assets	0	<u>\$4,390,000</u>	<u>\$7,410,000</u>
<i>Expenses</i>			
80. Barbados bank charges			10,000
81. Cayman bank charges			60,000
82. Jamaica bank charges			1,000
83. Jamaica travel expenses			120,500
84. Wires to Calderone	0	3,500,000	6,000,000
85. Spanish bank charges			10,000
86. Aruba bank charges			10,000
87. Bahamas bank charges			20,000
88. Schmidt Management Co.			45,000
Total offshore expenses	0	<u>\$3,500,000</u>	<u>\$6,276,500</u>
<i>Identified Income</i>			
89. Interest income — Cayman			640,000
90. Interest income — Spain			100,000
91. Interest income — Swiss			100,000
92. Interest income — Aruba			150,000
93. Interest income — Jamaica			7,500
Total identified offshore income	0	0	997,500
<i>Legal/identified income</i>	<u>\$7,869,600</u>	<u>\$9,469,850</u>	<u>\$13,915,900</u>

### **10.5.2 Expenses**

This section records the disbursements made from the various bank accounts that have been identified (Table 10.2, lines 80 through 88). Mr. Calderone received a large part of the funds by wire transfer. These payments are probably for drug purchases. Wire transfers are a quick and easy way of disbursing funds. Some charges are for bank fees. Doe had some personal expenses, since he paid for a hotel and other expenses in Jamaica. The payments to Schmidt Management Co. are for the formation of Doe Holding NV, a foreign corporation. If this were an active corporation, these expenses would be capitalized on the corporate books; they would not be considered personal expenditures. Expenditures on a shell corporation are considered personal expenses.

### **10.5.3 Income**

The identified income from offshore activities is from interest income from Doe's savings accounts (Table 10.2, lines 89 through 93). Those accounts held under corporate names are identified as his personal income, since those offshore corporations are only shells. Shell corporations are just a way of hiding income from authorities.





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## 11.1 General

The following solution and explanation relate to the scenario problem presented in Chapter 7. The solution and explanation are based on the tax expenditure principles.

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## 11.2 Principles

The tax expenditure method is based on the federal income tax laws and regulations. The federal tax code defines a few concepts. One concept is gross income. Gross income means income from whatever source unless specifically exempt. Adjusted gross income is another concept. It means gross income less specified deductions. Some of these deductions are Individual Retirement Account contributions, Keogh plan contributions, alimony payments, and others. Taxable income is another concept, which involves subtracting exemptions, itemized deductions, or standard deductions from adjusted gross income. These principles are the same for both the net worth method and the expenditure method. The first objective in a tax expenditure method is to establish adjusted gross income or corrected adjusted gross income if the taxpayer filed a tax return. After adjusted gross income is determined, then taxable income or corrected taxable income must be determined. Some itemized deductions have limitations, which are based on adjusted gross income. Medical expenses are an example of a category of deductions that have limitations on the amount deductible based on the adjusted gross income. Whether the user is applying the net worth method or the expenditure method, the bottom line should be the same, as is shown in these examples.

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## 11.3 Problem

The following expenditure schedule shows how each item in the scenario problem is presented. An explanation of why it is presented in the manner shown is given after the expenditure schedule. The explanation section will refer to the line items on the expenditure schedule.



### **11.3.1 Tax Expenditure Schedule**

The expenditure schedule is shown below. The first section shows all the expenditures by the taxpayer. The second section shows all nontaxable sources of income or receipts. Adjusted gross income is determined by subtracting nontaxable income from the total expenditures. From adjusted gross income, exemptions and itemized deductions or the standard deduction are subtracted to arrive at the corrected taxable income (if the taxpayer previously filed). This is compared to what the taxpayer reported for possible increases. The explanations refer to the line item on the expenditure schedule and the paragraph in the scenario problem.

#### **11.3.1.1 Cash on Hand**

Cash on hand is based on the currency found at John Doe's residence during the execution of the search warrant (Table 11.1, line 1). Cash on hand should be established as much as possible for each period and should show the addition to or the use of funds for the period, and not the ending balance.

#### **11.3.1.2 Cocaine, 2 Kilos**

Market value of cocaine is used in this solution (Table 11.1, line 2). This is a situation where market values are used; the primary reason is that receipts will not be available. It is well known that the taxpayer purchased the cocaine. There were no facilities discovered in which the cocaine was manufactured. This implies or suggests that the taxpayer purchased the cocaine. The Drug Enforcement Agency and other local law enforcement agencies keep statistics on the market value of drugs on a regular basis.

#### **11.3.1.3 Gold Bullion**

The 10 gold bars are recorded at cost (Table 11.1, line 3). The market value at the time of the search warrant is higher than the original cost. If the cost and date of purchase are not known, then the market value and time of discovery can be used. If the market value is used, then the burden of proof is placed on the defense to establish cost and date of purchase. The defense is not going to do this since it would be an admission by the defendant.

#### **11.3.1.4 First National Bank Accounts**

Increases or decreases in bank balances are reflected in this section (Table 11.1, lines 4 and 5). The increase or decrease in bank balances can be based on either the book changes or the bank balance changes. Whatever method is used, it must be used consistently. It is suggested that a better way of presenting the changes in bank balances is to show the ending balances on the expenditure schedule and subtract the beginning balance. It shows the jury from where the figures came and how they were obtained. Also, it helps confirm the change computations.

#### **11.3.1.5 Business Cash in Bank**

This bank account is based on changes in book balances (Table 11.1, line 6). The sole proprietorship keeps its books on the accrual method of accounting. This method recognizes income and expenses when incurred and not when received or paid. The changes in book balances are used because (1) books and records are kept of each transaction, which

show their appropriate time of occurrence; (2) timing differences are eliminated; and (3) bank reconciliations will normally be available to prove the book balances of accounts. In this case, the changes in bank balances increase during one year and decrease the subsequent year.

#### **11.3.1.6 Accounts Receivable**

Assets of a sole proprietorship are assets of the individual since he has title and personal liability (Table 11.1, line 7). The expenditure method recognizes the net changes in these assets. Accounts receivable are intangible assets that account for funds owed by customers to the sole proprietor, John Doe.

#### **11.3.1.7 Inventory**

Inventory is an asset of the sole proprietor (Table 11.1, line 8). He has title and personal liability for inventory. The expenditure method recognizes only the net changes during the period. In this case, inventory increased for the first year and decreased the following year.

#### **11.3.1.8 Business Assets**

These assets are the property of John Doe, the sole proprietor, since he has title (Table 11.1, line 9). The expenditure method only recognizes acquisitions and dispositions during the period.

#### **11.3.1.9 100 Alpha Street**

The purchase of the house is recorded at cost (Table 11.1, line 10). In this case, public records are used to determine the cost. However, the closing statement from the closing agent can be used, which would also show additional closing costs.

#### **11.3.1.10 100 Bravo Street**

The purchase of the apartment building is recorded at cost (Table 11.1, line 11). Public records are used to determine the cost. The closing statement can be used, which would show additional closing costs charged by the escrow agent.

#### **11.3.1.11 Furniture**

The furniture is recorded at cost for the period purchased (Table 11.1, line 12).

#### **11.3.1.12 Cabinets**

Cabinets are recorded at cost for the period purchased (Table 11.1, line 13).

#### **11.3.1.13 Paintings**

Paintings are recorded at cost for the period acquired (Table 11.1, line 14).

#### **11.3.1.14 Fixtures**

Fixtures are recorded at cost for the period purchased (Table 11.1, line 15).

**Table 11.1 John Doe's Tax Expenditure Schedule (Title 26)**

Description	19X1	19X2	19X3
<i>Expenditures</i>			
1. Cash on hand	\$0	\$0	\$50,000
2. Cocaine, 2 kilos			50,000
3. Gold bullion	100,000		
4. First National Bank (FNB) checking	10,000	40,000	50,000
5. FNB savings	110,000	440,000	100,000
6. Business bank account		20,000	(10,000)
7. Accounts receivable		10,000	10,000
8. Inventory		140,000	(90,000)
9. Business assets		150,000	
10. 100 Alpha Street	300,000		
11. 100 Bravo Street	4,000,000		
12. Furniture	50,000		
13. Cabinets	20,000		
14. Paintings	20,000		
15. Fixtures	10,000		
16. Pool and tennis court	100,000		
17. Appliances		20,000	
18. Electronic equipment		100,000	
19. Security system			50,000
20. Lounge Doe, Inc.	2,440,000		
21. Doe Kwik Stop, Inc.	481,100	(155,100)	175,000
22. Real Property, Ltd.	1,930,000	(52,500)	12,500
23. Mercedes Benz	80,000		
24. Toyota sedan		18,000	
25. IRA — Doe		2,200	2,400
26. IRA — Que		2,200	2,400
27. Bahamas residence		110,000	
28. Florida Mortgage Corp.	70,000	120,000	120,000
29. Mercedes Benz loan	9,000	12,000	12,000
30. Toyota sedan loan		1,200	2,400
31. Prepaid interest	8,500	1,760	
32. Florida Mortgage interest	200,000	188,000	176,000
33. Business bank loan			20,000
34. Life insurance	10,000		
35. Income tax withheld	95,000		150,000
36. Property tax	5,000		5,000
37. Credit card payments	30,000	70,000	160,000
38. Utilities	10,000	10,000	20,000
39. Telephone	30,000	40,000	45,000
40. Insurance	5,000	10,000	10,000
41. Church donations		10,000	50,000
42. Interest — Mercedes	1,500	2,000	2,000
43. Interest — Toyota		240	480
44. Trust funds			400,000
Total expenditures	<u>\$10,125,100</u>	<u>\$1,310,000</u>	<u>\$1,575,180</u>
<i>Nontaxable Sources</i>			
45. Fla Mortgage Corp.	2,000,000		
46. Mercedes Benz loan	60,000		
47. Toyota sedan loan		10,000	
48. Business bank loan		100,000	
49. Accounts payable			50,000
50. Income tax refunds	500	79,250	
51. IRA — Doe		2,200	2,400
52. IRA — Que		2,200	2,400
53. Depreciation	100,000	230,000	230,000
54. Prepaid interest		2,000	2,480
Total nontaxable sources	<u>\$2,160,500</u>	<u>\$425,650</u>	<u>\$287,280</u>
Adjusted gross income	<u>\$7,964,600</u>	<u>\$884,350</u>	<u>\$1,287,900</u>

**Table 11.1 John Doe's Tax Expenditure Schedule (Title 26)**

Itemized deductions	206,500	200,240	233,480
Exemptions	2,000	2,000	2,000
Corrected taxable income	<u>\$7,756,100</u>	<u>\$682,110</u>	<u>\$1,052,420</u>
Reported taxable income	63,000	0	285,400
Increase	<u>\$7,693,100</u>	<u>\$682,110</u>	<u>\$767,020</u>

**11.3.1.15 Pool and Tennis Court**

These assets are recorded at cost for the period purchased (Table 11.1, line 16). If there were subsequent purchases or additional costs, these would be shown for the period incurred, and not when the contract was signed. Only period costs should be shown, not accumulated balance.

**11.3.1.16 Appliances**

Appliances are recorded at cost for the period acquired (Table 11.1, line 17).

**11.3.1.17 Electronic Equipment**

These assets are recorded at cost for the period purchased (Table 11.1, line 18).

**11.3.1.18 Security System**

This asset is recorded at cost for the period acquired (Table 11.1, line 19).

**11.3.1.19 ABC Stock Purchase**

This intangible asset is recorded at cost for the period purchased. The cost is reflected on the expenditure schedule. However, this asset was sold during the period. Any gain or loss will not be recognized on the expenditure schedule since this is an adjustment to arrive at adjusted gross income.

**11.3.1.20 Lounge Doe, Inc.**

This investment is recorded at the net cash investment for the period (Table 11.1, line 20). This can be either a positive or negative change. A negative change means the taxpayer withdrew more funds than what was invested into the corporation during the period. The boat is a corporate asset and not the shareholders'. The corporation is taxed on its income and not the shareholders'. The net investment should take into consideration capital stock, additional paid in surplus, and loans from shareholders. If the corporation has made any loans to the shareholders, then they should be subtracted from the other investment accounts.

**11.3.1.21 Doe Kwik Stop, Inc.**

This is a Sub S corporation (Table 11.1, line 21). Like taxable corporations, the expenditure schedule should reflect the net cash investment from all accounts, but in addition, the earnings and losses for the period. Sub S corporations are not taxed, but the earnings and losses are passed on to the shareholders. It should also be noted that Sub S corporations cannot have a negative balance. Losses on Sub S corporations are limited to the shareholders' investment.

### **11.3.1.22 *Real Property, Ltd.***

Investment into this partnership by the partner is recorded at the net cash investment, plus any earnings, less any losses for the period (Table 11.1, line 22). The other partner's interest is not considered. Partnership assets belong to the partnership and not to the partners. If the partner's assets can be identified separately from the others, then they can be severed. The partnership is not a taxable entity. The partner can have a negative basis provided that the partner is at risk for his share of the partnership liabilities. The expenditure method only recognizes the changes in the partnership investment for the period, and not year-end balances.

### **11.3.1.23 *Mercedes Benz***

This car is recorded at cost during the period purchased (Table 11.1, line 23). A problem can arise if another car was traded in for this one. In the same manner as in the net worth method, the trade-in allowance will have to be accounted for. In essence, the gain or loss on the old car will increase or decrease the cost of the new car.

### **11.3.1.24 *Toyota Sedan***

This vehicle is recorded at cost during the period purchased (Table 11.1, line 24). The car is charged to John Doe since he paid for it. This vehicle can be shown either as a gift or as an asset purchase. Since the car is financed and John Doe is probably making the payments, this vehicle should be shown as an asset.

### **11.3.1.25 *IRA Accounts***

Contributions to Individual Retirement Accounts and Keogh plans should be shown for the period (Table 11.1, lines 25 and 26). These accounts will also have earnings for the period. Contributions to these plans are an adjustment to arrive at adjusted gross income. The earnings are nontaxable until withdrawn. Therefore, there are two ways to present these items. One is to completely ignore them. The issue in this case would be that the taxpayers have an asset that they can access. The other way of presenting this issue is to show the contributions and earnings, and later back out the earnings and contributions as a nontaxable source.

### **11.3.1.26 *Bahamas Residence***

This asset should be shown at cost for the period acquired (Table 11.1, line 27). One issue involved in this case is the possible conversion from a foreign currency to U.S. currency. Any gain or loss on the conversion is not recognized since this would be an adjustment to arrive at adjusted gross income.

### **11.3.1.27 *Florida Mortgage Corp.***

The proceeds from a mortgage should be shown on the expenditure schedule as a nontaxable source of funds (Table 11.1, line 28). The payments to the mortgage company should be shown as an application of funds. Mortgage payments usually include principal and interest. Many times, escrow payments are included to cover property taxes and insurance. A breakdown of these payments will have to be made as to both principal and interest. If escrow payments are included in the mortgage payments, then a breakdown of the escrow payments will have to be made as to changes in the escrow balance, property taxes, and insurance paid for the period.

**11.3.1.28 Automobile Loans**

The proceeds from installment loans should be shown as a source of funds for the period obtained (Table 11.1, lines 29 and 30). The payments to these installment loans should be reflected as an application of funds. A problem arises when the bank adds the interest to the principal balance. The interest is for the whole period of the loan, which normally extends beyond the period in question. In this situation, the interest is shown as an expenditure. The interest is amortized over the period of the loan and is later shown as an itemized deduction. For the initial year that the loan was obtained, the prepaid interest is divided up between the current year's expense and the unamortized expense.

**11.3.1.29 Prepaid Interest**

This is the unamortized portion of the interest charged by the bank on installment loans (Table 11.1, line 31). This interest is amortized over subsequent periods. It is shown as an expense and later as an itemized deduction, if deductible.

**11.3.1.30 Mortgage Interest**

This is the interest portion of the mortgage payments to Florida Mortgage Corp. (Table 11.1, line 32) that were paid during the period. This same amount will also be shown on the itemized deduction schedule.

**11.3.1.31 Life Insurance**

This is an expense for the period incurred (Table 11.1, line 34). It is not amortized over the period for which the premium was incurred. If this were a medical insurance premium, then an itemized deduction would be made in subsequent years, subject to limitations. Prepaid medical insurance should be treated the same way as prepaid interest on installment loans.

**11.3.1.32 Income Tax Withheld**

This is a period expenditure (Table 11.1, line 35). Even though a refund is made in later years, withholding is recognized during the period withheld.

**11.3.1.33 Property Tax**

This is an expense for the period involved (Table 11.1, line 36). In addition, this expenditure is also an itemized deduction.

**11.3.1.34 Credit Card Charges**

This is an expense for the periods involved (Table 11.1, line 37). This case shows only the amount of funds paid to the credit card company, and not the charges made against it. The expenditure method uses the payments to the credit card company instead of the charges. If the credit card has charges for business expenses, then payments for these expenses will have to be subtracted from the payments.

**11.3.1.35 Utilities**

This is an expense for the periods involved (Table 11.1, line 38).

**11.3.1.36 Telephone**

This is an expense for the periods involved (Table 11.1, line 39).

**11.3.1.37 Insurance**

This is an expense for the periods involved (Table 11.1, line 40).

**11.3.1.38 Church Donations**

This is an expense for the periods involved (Table 11.1, line 41). In addition, these are itemized deductions, which are subject to limitations.

**11.3.1.39 Installment Loan Interest**

This is an expenditure for the period (Table 11.1, lines 42 and 43). This is the portion of interest charged by the bank that is expensed for the period. It also is used as an itemized deduction. In subsequent periods, the interest is shown as an expense and as a possible itemized deduction. Another way of presenting the future amortized interest and itemized deduction is not to show it at all.

**11.3.1.40 Trust Funds**

This is an expense for the periods involved (Table 11.1, line 44). Trusts should be examined closely because they may be funds to which the contributor can obtain access.

**11.3.1.41 XYZ Stock Loss**

Losses on the sale of capital assets, such as stock, in this case, are an adjustment to arrive at adjusted gross income. Therefore, losses are ignored in this case.

**11.3.1.42 Mortgage Proceeds**

The mortgage proceeds from the Florida Mortgage Corp. are a nontaxable source of funds (Table 11.1, line 45). The gross proceeds should be recognized as a source of funds. Any closing costs should be expensed or added to the cost of the real property.

**11.3.1.43 Automobile Loans**

The installment loans for the purchase of automobiles are shown as a nontaxable source of funds (Table 11.1, lines 46 and 47). Installment loans should be shown with both principal and interest charged for the term of the loans. The interest for the loan term will offset the initial loan balance with a charge to prepaid interest. For subsequent years, the prepaid interest will be amortized as an expenditure for the period. Installment loan payments are shown on the expenditure side of the expenditure schedule.

**11.3.1.44 Business Bank Loan**

John Doe, the sole proprietor, borrowed funds from the bank (Table 11.1, line 48). Even though this is a business loan, John Doe is personally liable. This is a nontaxable source of funds, which should be recognized when received.

**11.3.1.45 Accounts Payable**

Accounts payable of a sole proprietorship are liabilities of the individual (Table 11.1, line 49). The individual is personally liable for business payables of the sole proprietorship. The expenditure method recognizes the net changes in this account for the period.

**11.3.1.46 Income Tax Refunds**

This is a source of funds during the period received (Table 11.1, line 50). This should be shown as a nontaxable source.

**11.3.1.47 IRA Accounts**

As explained earlier, if this is to be shown as an expenditure for the period, then it has to be offset by a nontaxable source of funds. The purpose is to arrive at adjusted gross income (Table 11.1, lines 51 and 52). When preparing an individual tax return, this is an adjustment to gross income in order to arrive at adjusted gross income.

**11.3.1.48 Depreciation**

This is considered a nontaxable source of funds for the period (Table 11.1, line 53). This does not deal with the source of funds. It is considered a phantom figure for Racketeer Influenced and Corrupt Organization (RICO) purposes. For tax purposes, it is considered a source of funds on the grounds that it is a potential liability. Federal laws and regulations require the recovery of depreciation as ordinary taxable income to the extent of any gain recognized on the sale of the depreciable asset. Depreciation, amortization, and depletion charges for the current period are recognized, but not the accumulated balances.

**11.3.1.49 Prepaid Interest Reduction**

Installment loans have been recorded with prepaid interest for the term of the loan (Table 11.1, line 54). The tax expenditure method requires this prepaid interest to be capitalized and amortized over the term of the loan. During subsequent years, the prepaid interest account will be reduced by the amount of interest recognized for the period. This reduction of the prepaid interest account is a source of funds and becomes an expense for the period. The expense was recognized above (Table 11.1, lines 42 and 43).

**11.3.1.50 Itemized Deductions**

Itemized deductions or the standard deduction are allowed to reduce adjusted gross income to derive taxable income. The federal income tax code allows certain expenses to be deducted. The primary ones are medical expenses, interest expenses, certain taxes, charity donations, and some other miscellaneous expenses. In this solution, itemized deductions are the total of personal expenditures for interest (mortgage and amortized interest), church donations, and property taxes. Limitations on these deductions, which are built into the tax code, have been ignored in this problem. The itemized deductions are identified below:

Description	19X1	192X	19X3
Florida Mortgage interest	\$200,000	\$188,000	\$176,000
Mercedes interest	1,500	2,000	2,000
Toyota interest		240	480
Property taxes	5,000		5,000
Church donations		10,000	50,000
Total	<u>\$206,500</u>	<u>\$200,240</u>	<u>\$233,480</u>

**11.3.1.51 Exemptions**

Exemptions are an income tax concept. The amount of these exemptions varies from year to year. For the sake of simplicity, \$2,000 per exemption is used in this case.



## 11.4 Offshore Evidence

This scenario problem shows many offshore assets and financial transactions. Offshore transactions are generally not admissible in court. However, there are some exceptions. Public records in foreign countries are admissible when properly certified. The Bahamas residence in this case is one example. Land transfer records are open to the public in the Bahamas, as well as in many other countries. Bank records are usually not public, and in many countries improper disclosure can result in criminal and civil actions. Some tax haven countries' bank records are not allowed in criminal or civil tax cases. One major problem in admitting foreign nonpublic records is obtaining a witness to introduce them into court. Government budgets may not allow the travel expenses of the witness. Many foreign nationals do not like to testify in court, especially if they feel they can be charged for aiding and abetting.

## 11.5 Offshore Records

Now it will be assumed that witnesses will be obtained to introduce evidence into court. This offshore evidence, as you will see, has a material effect on the tax expenditure method. The tax expenditure schedule will be modified as shown in Table 11.2.

### 11.5.1 Doe Holding NV

The net cash investment in this foreign corporation for the period is reflected on the expenditure schedule (Table 11.2, line 58). The fees paid to Schmidt Management Co. are for the creation of this corporation. Thus, this is a corporate expenditure. The expenditure method shows the net cash investment for the period. Like any offshore transaction, it must be shown in U.S. currency, and any gain or loss on the conversion must also be recognized. The tax expenditure schedule does not recognize any gains or losses on currency exchange since this is an adjustment to arrive at adjusted gross income.

**Table 11.2 John Doe's Tax Expenditure Schedule with Adjustments for Offshore Activities (Title 26)**

Description	19X1	19X2	19X3
Previous corrected income	\$7,756,100	\$682,110	\$1,052,420
<i>Expenditures</i>			
55. Bahamian bank account		4,390,000	(3,890,000)
56. Spanish bank account			1,090,000
57. Swiss bank account			2,090,000
58. Aruba bank account			2,565,000
59. Barbados bank account			2,189,000
60. Cayman bank account			2,580,000
61. Jamaica bank account			786,000
62. Barbados bank account			10,000
63. Cayman bank charges			60,000
64. Jamaica bank charges			1,000
65. Jamaica travel expenses			120,500
Corrected taxable income	7,756,100	5,072,110	8,653,920
Reported taxable income	63,000	0	285,400
Increase	<u>\$7,693,100</u>	<u>\$5,072,110</u>	<u>\$8,368,520</u>

### **11.5.2 Offshore Bank Charges**

These expenses are recognized during the period paid (Table 11.2, lines 62 through 64). The main issue in these expenditures is the conversion of foreign currency to U.S. currency. This problem does not address this issue.

### **11.5.3 Jamaica Travel**

This is an expenditure for the period (Table 11.2, line 65). Expenditures are recognized only during the period paid.

### **11.5.4 Transshipment, Ltd.**

This is a Bahamian corporation. Its only assets and capital are the bank accounts set up by the sole shareholder (Table 11.2, lines 55 through 57). The Spanish and Swiss banks are interest-bearing accounts, since they are credited with interest income. This income is an adjustment to arrive at adjusted gross income. Therefore, it is ignored. Since some expenditures cannot be specifically identified, other than those that are transferred to other bank accounts, only the changes in the bank balances are used. The Bahamian bank account shows payments going to Calderone, who is a known drug trafficker; however, he cannot be used as a witness. The reason should be obvious: he could not testify without self-incrimination.

### **11.5.5 Foreign Bank Accounts**

Changes in bank balances are recognized as sources or expenditures of assets, principally cash (Table 11.2, lines 59 through 61). If the bank account balances go up, as they do here, this is an application of funds. If the bank account balances go down, then they are a source of funds.





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## 12.1 Definition

Both the judicial and legislative branches have had disputes in defining organized crime. In 1967, the Administration of Justice defined organized crime as “a society that seeks to operate outside the control of the American people and their government. It involves thousands of criminals, working within structures as large as those of any corporation.” The McClellan Committee, following highly publicized investigations, increased public awareness of organized crime as a pervasive social force and prompted federal legislative action. However, it did not sufficiently emphasize the importance and roles of groups other than La Cosa Nostra in American organized crime. In 1968, Congress passed into law the first major organized crime bill: the Omnibus Crime Control and Safe Streets Act. This act defined organized crime as the unlawful activities of the members of a highly organized, disciplined association engaged in supplying illegal goods and services, including, but not limited to, gambling, prostitution, loan-sharking, narcotics, labor racketeering, and other unlawful activities. In 1970, Congress passed the Racketeer Influenced and Corrupt Organization (RICO) statute, which has become the centerpiece of federal law, proscribing organized criminal activity. RICO defines racketeering activity as any act or threat involving murder, kidnapping, gambling, arson, robbery, bribery, extortion, or dealing in narcotic or dangerous drugs and other denominated crime. A pattern of racketeering activity requires at least two acts of racketeering activity.

Organized crime is the collective result of the commitment, knowledge, and actions of three components: the criminal groups, each of which has at its core persons tied by racial, linguistic, ethnic, or other bonds; the protectors, persons who protect the group’s interests; and specialist support, persons who knowingly render services on an *ad hoc* basis to enhance the group’s interests.

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## 12.2 Criminal Group

The criminal group is a continuing, structured collective of persons who utilize criminality, violence, and a willingness to corrupt in order to gain and maintain power and profit. The characteristics of the criminal group are continuity, structure, criminality, violence, membership based on a common denominator, a willingness to corrupt, and a power/profit goal.

The criminal group carries out its purpose over a period. The group operates beyond the lifetime of individual members and is structured to survive changes in leadership. At different times, activities are focused, organized, and controlled in various ways. Group members work to ensure that the group continues and their interests are subordinate to those of the group.

The criminal group is structured as a collection of hierarchically arranged interdependent offices devoted to the accomplishment of a particular function. It can be highly structured or fluid. It is distinguishable and ordered in ranks based on power and authority.

Membership is the core in a criminal group that is restricted and based on a common trait, such as ethnicity, race, criminal background, or common interest. Potential members of a criminal group are closely scrutinized and required to prove their worth and loyalty to the criminal group. Membership in most instances requires a lifetime commitment. The rules of membership include secrecy, a willingness to commit any act for the group, and intent to protect the group. In return for loyalty, the criminal group member receives benefits from the group, including protection, a certain prestige, an opportunity for economic gain, and, perhaps most importantly, a sense of belonging.

### **12.2.1 Criminality**

Organized crime is aimed at the pursuit of profit along well-defined terms. The criminal group relies on continuing criminal activity to generate income. Some groups engage in a range of illegal activities, while others limit themselves to one central activity. Some criminal groups are involved in legitimate business activities in order to skim or launder profits and increase their power.

### **12.2.2 Violence**

Violence and the threat of violence are an integral part of the criminal group. Both are used to control and protect against both members of the group who violate their commitment and those outside the group to protect it and maximize its power. Members are expected to commit, condone, or authorize violent acts.

### **12.2.3 Power/Profit Goal**

Members of a criminal group are united in that they work for the group's power and ultimately its profit. Political power is achieved through the corruption of officials. The group's structure and the fear it instills through the use of violence manifest power. The criminal group maintains power through its association with criminal protectors, who defend the group and its profits.

### **12.2.4 Protectors**

The protectors are a complement of corrupt public officials, attorneys, and businessmen who individually or collectively protect the criminal group through abuses of status or privilege and violation of law. Protectors include lawyers, judges, politicians, financial advisors, financial institutions, and business in the U.S. and worldwide. As a result, the criminal group is insulated from both civil and criminal government actions. Protectors are members of organized crime. The success of organized crime is dependent upon this buffer, which helps to protect the criminal group from civil and criminal action.

### 12.2.5 Specialist Support

The criminal group and protectors rely on skilled individuals or specialists to assist in the attainment of group goals. These individuals do not share a continuing commitment to the group's goals. They are nonetheless considered part of organized crime.

## 12.3 Groups

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There will be little lasting benefit in disabling La Cosa Nostra if other groups successfully claim its abandoned criminal franchises. If progress is to be made, the perspective of organized crime must be on not only the current groups, but also their possible successors and the protectors of organized crime.

### 12.3.1 La Cosa Nostra

La Cosa Nostra (This Thing of Ours) has been the largest, most extensive, and most influential crime group in this country for more than a half century. Today, it must share some of the criminal enterprises that it once thoroughly dominated with newer crime groups. La Cosa Nostra (LCN) undertakings range from heroin trafficking to storefront numbers operations, from extortion by violence to sophisticated infiltration of legitimate businesses. The LCN is so formally organized, so broadly established, and so effective that it can demand a portion of the proceeds of other crime groups.

#### 12.3.1.1 *Background and Structure*

The basic territorial unit with La Cosa Nostra is the family, known as a borgata. The name does not imply any blood relationship. The LCN families total about 1,700 members, with a concentration in the northeastern U.S. About half the strength is in the five New York families. The number of formal members represents only a small portion of the criminal network by which the organization survives and prospers.

Nearly all the LCN families around the country fall under the authority of the national commission, established by Salvatore "Lucky" Luciano in 1931. The exception is the New Orleans family, the longest established LCN group, which is independent of the commission in most matters. The commission traditionally has consisted of the bosses or acting bosses from the five New York families, and bosses from several of the more important families around the country. Besides the five New York bosses, the LCN commission currently includes bosses from Buffalo, Chicago, Detroit, and Philadelphia.

The national commission regulates joint ventures between families, intervenes in family disputes, approves the initiation of new members, and controls relations between the U.S. and Sicilian branches of La Cosa Nostra. In 1964, electronic surveillance by the FBI recorded a conversation in which Sam DeCavalcante, boss of the New Jersey family, discussed the commission's intervention in a leadership struggle within New York's Joseph Profaci's family.

While the commission has precedence in issues that affect the overall conduct of LCN and its families, lesser rights are still reserved for the individual families, such as what they do, who they kill, and who they do business with, as explained by informant James Fratianno, a former member of the Los Angeles LCN group.

Not all LCN families have equal power; those in the West are less formally organized, and their leadership is less easily identified. Law enforcement has speculated that power within LCN is gravitating to Chicago. The five New York families influence activities as far west as Chicago, while the midwestern and western families are believed to report to the boss of the Chicago LCN family. Angelo Lonardo, a former Cleveland underboss, has testified that Chicago dominates midwestern families, while the Cleveland LCN family reports to New York. Ken Eto, a former associate of the Chicago family, has stated that the Cleveland family is subordinate to the Genovese family in New York.

The structure of a La Cosa Nostra family typically consists of the following positions:

**Boss.** He is head of the family. He does not participate in the day-to-day activities of the organization, but is supposed to receive a cut from every income source. He usually has his own legitimate and illegitimate businesses.

**Underboss.** He assists the boss. Usually he is being groomed to succeed the boss, but succession is not automatic. There is only one underboss per family.

**Consigliere.** Literally, “counselor.” He assists the boss, but has no leadership authority. He is generally an older, experienced member who can advise family members. There usually is only one per family.

**Capo.** Caporegima, or captain. Supervises the family’s day-to-day criminal operations and represents the family among the soldiers, whom he oversees. A capo gains his position by proving his ability as an earner, one who earns a great deal of profit for the family. He may have his own legitimate and illegal ventures, and he retains part of the income paid by his soldiers before passing it on to the leadership. The number of capos in a family depends on the size of the family.

**Soldier.** This is the basic rank in the family. Sometimes known as a wise guy, button, or made man; the last term refers to any formal member of the LCN, one who has undergone the initiation ritual. To be “made,” a man must be of Italian ancestry.

**Associates.** This an informal position, yet one that is crucial to the family. An associate need not be of Italian descent; he is someone whose skills or position make him valuable to the organization. Some are used as soldiers, while others are more distantly connected. The FBI has estimated that for every formal member of the LCN there are 10 criminal associates who cooperate with members and share their enterprise.

**Protectors.** Among any family’s associates is a support network of protectors. These are corrupt public officials, bankers, lawyers, accountants, and other professionals who protect the criminal group from governmental action, both civil and criminal. Angelo Lonardo has described the role of Milton Rockman, who acted as a conduit for cash skimmed from Las Vegas casinos for several Midwest families: “We all belonged to the same organization. He always took care of the labor movement and financial movement, but he was a member of the organization, however he wasn’t a member of the family.”

La Cosa Nostra structure usually insulates the boss from the crimes committed by soldiers in his family. Often he receives money derived from illegal enterprises that he did not organize and about which he has no real knowledge.

### **12.3.1.2 Activities**

The true nature of La Cosa Nostra is derived from the lowest and uppermost elements of its overall structure. The existence of the commission, the highest level of authority, makes the American LCN an organized crime group in every sense of the definition — a cartel with national oversight — and it is the soldier who makes the organization such a truly predatory creation.

The soldier is Italian and male. Typically, he already has a background in burglary and robbery before he is considered for membership. Except in unusual circumstances, a candidate for membership cooperates with family members in some criminal tasks as part of a testing process; he may be asked to participate in a murder, at least as an accomplice. Before he is accepted as a member, his name will be circulated around the family. In New York, other family bosses will review the name. Associates do part of the screening with contacts in law enforcement.

To be a “made” member of the LCN requires a sponsor. This is no casual relationship, since the sponsor’s life may be in jeopardy if the initiate later turns sour. The candidate vows that the organization will be foremost in this life and acknowledges that only death will release him from the oath. One immediate effect of his new status is that among other members, he will now be referred to as “a friend of ours,” while associates and outsiders are referred to as “a friend of mine” when one member introduces them to another.

Martin Light, an attorney close to the LCN and serving a sentence for a drug conviction, testified on January 29, 1986, and stated that prospective members are watched from childhood on, judged on their toughness and ability and on their respect for superiors. Their willingness to “do the right thing” may be to share criminal profits with family leaders, to risk a jail term for refusal to testify before a grand jury, or to plead guilty to a crime actually committed by more important figures in the family. It is to follow unquestioningly the self-perpetuating practices of a most secret and exclusive criminal society. Rank in the LCN is strictly observed. Dealings between families always involve members of equal rank; an underboss will deal only with his counterpart in another organization. Within a given family, a boss deals exclusively with his consigliere and underboss, from which the captain gets his orders. Each captain has a crew of several soldiers who are affiliated with him for life, and each soldier has a crew of nonmember associates, some of whom may be Italian, prospects for initiation some day. Thus, several buffers are created between the lowest and topmost levels of the family.

The soldier is the lowest-ranking formal member of the organization, but he commands respect and fear on the street. Light testified that Gregory Scarpa, a soldier of the Colombo family, would not allow anyone to do anything without getting his permission, even down to double-parking.

Even as the captains and the family leadership reap the fruits of the soldier’s aggressiveness and respect, they are also engaged in large-scale crime that requires the full influence and capital of the family. A partial recounting of LCN criminal activities is a virtual catalog of organized crime: drug trafficking, illegal gambling, extortion, theft, fraud, prostitution, loan-sharking, labor racketeering, embezzlement, money laundering, bribery, bombing, hijacking, kidnapping, auto theft, arson, kickbacks, burglary, smuggling, and forgery are all common.

There are regional differences. In the northeast, labor racketeering and infiltration of the construction trades are among the LCN’s primary activities, while firearms trafficking is common in the north-central region. The Bruno family in Philadelphia seems to be



more heavily involved than other families in the trafficking of methamphetamines. Forgery and arson are prominent in the southern and western regions.

Intelligence reports that gambling is the largest source of income for the midwestern LCN groups, which are supported by the recent trail of family leaders from Chicago, Kansas City, Milwaukee, and Cleveland in the Argent Corporation skimming case; in the conviction of Carl Deluna and others in a similar 1983 skimming case involving the Tropicana Casino in Las Vegas, in the 1985 bookmaking convictions of Caesar DeVarco and others in Chicago; and by the guilty pleas entered by Kansas City LCN figures Anthony and Carlo Civella on gambling charges in 1984. Chicago also is considered one of the few cities where prostitution is controlled by the LCN.

The New Orleans family of Carlos Marcello generates most of its income by infiltrating legitimate businesses, and gains most of its power through political influence. New Orleans serves as an example for other LCN families, which in recent years have infiltrated legitimate businesses, including liquor and food purveyors, restaurants, construction, banking, vending, jewelry, meat packing, sanitation and toxic waste disposal, imports and exports, tobacco, and laundry, among many others.

### **12.3.1.3 Prosecutions and Their Effect**

During the 1980s, the leadership in 17 of 24 La Cosa Nostra families has been indicted or convicted. In 1984, organized crime indictments totaled 2,194, involving predominately LCN members and associates. One of the most valuable tools for prosecutors has been the Racketeer Influenced Corrupt Organization (RICO) Act, signed into law in 1970, which recognizes the true institutional nature of organized crime.

Professor Howard Abadinsky believes that the arrest of a single capo or even a boss does not disrupt the entire organization because family power is decentralized. He further adds that imprisonments may serve as the equivalent of forced retirement, allowing younger members to move into authority. The FBI, from its investigations, has seen this trend.

Ronald Goldstock, former head of the New York Organized Crime Task Force, sees the families move from active crime into financing crime by others, such as importing heroin or backing numbers operations. This has become more prevalent in recent years due to the large number of LCN prosecutions. Law enforcement intelligence has found that the LCN is helping the Triads, the Colombian drug cartels, and the Russian mobs.

Working law enforcement has a different view. The imprisonment of LCN bosses has brought to power a generation of inexperienced leaders who have not been fully groomed for responsibility and who do not subscribe to the old customs of loyalty and secrecy, producing an organization that is more vicious, less skillful at crime, and less bound by honor and heritage than their predecessors. Financial ties are more easily broken than obligations of honor and loyalty. Numerous cases against LCN figures have hinged on the testimony of their former colleagues. Because of the convictions of LCN bosses and other high-level figures, the LCN has been recruiting members and killers from Sicily. Also, it has been sending soldiers to Sicily to learn the Mafia code of honor.

### **12.3.1.4 Sicilian Faction**

An important new development is the disclosure of an element of the Sicilian La Cosa Nostra that is operating in the U.S. Its existence was revealed almost simultaneously during a 1984 investigation of a heroin smuggling ring known as the Pizza Connection, which

involved Sicilian La Cosa Nostra crime boss Gaetano Badalamente and, by the testimony of Tommaso Buscetta, a high-level Sicilian LCN figure, who has become a witness for prosecutors in Italy and the U.S. It has been held that Sicilian members were bound to the American LCN families. It is now apparent that while Sicilian and American groups may cooperate in some crime, there is, in fact, an independent Sicilian organization in the U.S.

The LCN in Italy has undergone several periods of severe repression, including a purge by Mussolini in the 1920s. American groups became safe havens for Sicilian members during these periods of difficulty. During the 1920s, formative Sicilian members fled to the U.S. Among them were Joseph Bonanno, Carlo Gambino, Stefano Maggadino, and Joseph Profaci, men who were among the leadership of U.S. organized crime during the next 40 years.

There appears to have been a short break in relations between the two groups around 1950. In 1957, American LCN leaders Lucky Luciano, Joe Bonanno, Carmine Galante, and Frank Garofalo met in Palermo with Sicilian leaders, including Tommaso Buscetta and Gaetano Badalamente. One of the products of that meeting was the formation of a Sicilian commission similar to the one instituted by Luciano in 1931. Unlike the U.S. commission, the first Sicilian commission included soldiers, not bosses, and it dissolved in 1962.

In the early 1960s, the Italian LCN again came under intense pressure from police as a result of murderous factional conflict. Scores of LCN members in Italy were arrested and tried. LCN members fled to the U.S., Canada, and South America. Law enforcement experts naturally assumed that the new arrivals would be absorbed into existing families. However, these expatriates remained loyal to their original families in Sicily and formed the nucleus of an independent LCN group in the U.S.

Sicilian leaders established a second national commission, this one headed by Badalamente, Stefano Bontade, and Salvatore Reina. Around the end of 1977, Badalamente was expelled from his seat under pressure from the faction based in the Corleone area and went into exile, fearing for his life. Friction between the Corleonese group and Badalamente's organization resulted in what has become known in Italy as *La Grande Guerra* (The Great War). More than 500 LCN members and associates died in this conflict between 1980 and 1983, as Badalamente attempted to regain his position. Eventually, the Corleone faction prevailed, with Michele Greco as head of the commission. The Corleone faction has held exclusive rights in the Sicilian LCN to drug trafficking since 1981. Under the Corleonesi, the heroin industry in Sicily was taken from individual LCN members and supervised by family bosses. An elaborate smuggling network supplied morphine base from Afghanistan, Pakistan, and Iran to Sicilian processing labs, from which it was shipped via Spain or Switzerland, most often, to the U.S. and the Sicilian LCN faction in place here.

Michele Greco went into hiding in 1982 when Italian police made mass arrests of LCN figures following a series of murders of judges, prosecutors, and police. In 1984, Greco was sentenced in absentia to life imprisonment for the assassination of Palermo Judge Rocco Chinnici. On February 20, 1986, Greco was arrested at a farmhouse near Palermo and was bound over for trial with 467 suspected LCN members. Tommaso Buscetta became an informant for prosecutors in Italy and the U.S. after two of his sons, a son-in-law, two brothers, and two nephews died in *La Grande Guerra*. He was a key witness against Greco and the others.

**12.3.1.4.1 Sicilian Operations in the U.S.** The number of Sicilian LCN members in this country is not known. However, they are believed to be concentrated mainly in the northeastern U.S. They apparently operate without geographical restrictions. There has been little friction between U.S. families and Sicilian members in this country, which suggests that working agreements are in effect. In the Pizza Connection case, it has been documented that Sicilian members supplied heroin to an American LCN faction headed by Salvatore Catalano, capo of the Bonanno family. Since the early 1970s, the Sicilians have been one of the principal suppliers of Southeast Asian heroin in this country. They moved into the trade after the end of the French Connection, through which American LCN interest controlled the flow of Turkish heroin into this country. In 1977, authorities of the U.S., France, and Italy began assembling evidence of the Sicilian network. In 1980, Italian police discovered two labs in Palermo capable of processing up to 50 kilos of heroin per week.

The Sicilian LCN in this country has generated enormous amounts of cash that must be laundered through its drug trafficking operations. Members have bought into businesses in which illicit proceeds may be hidden along with the legitimate cash flow. The Sicilians have used investment schemes involving commodity futures, and a courier system for transporting bulk currency out of the U.S. to banks in the Bahamas and Bermuda, which would then transfer the funds to commercial accounts overseas. Sicilian members have also purchased large amounts of real estate. The property can be resold for its true value and the proceeds are considered legitimate.

## **12.3.2 Outlaw Motorcycle Gangs**

When they first appeared, outlaw motorcycle gangs were a disenchanting anomaly within the general contentment of the postwar U.S. groups of young men; newly returned soldiers formed motorcycle clubs and rejected normal civilian lifestyles. In the next few years their behavior was boisterous and rebellious. Today, there are 800 to 900 outlaw motorcycle gangs, ranging in size and sophistication from loosely organized single chapters to gangs with dozens of chapters in the U.S. and foreign countries. During the 1970s, at least four outlaw motorcycle gangs — Hell's Angels, the Outlaws, the Bandidos, and the Pagans — evolved into fully organized crime groups. Together, their member chapters reach across the Continental U.S. and into Europe and Australia. They engage in almost every conceivable crime, including murder, extortion, and highly involved drug trafficking schemes. They have been known to cooperate with LCN figures.

In addition to these four gangs, several other outlaw motorcycle groups are active in the U.S. They include the Sons of Silence (Midwest and Great Lakes region), the Vagos (Los Angeles and Mexico), the Peacemakers (southeastern U.S.), and the Dirty Dozen (Arizona and the Southwest). None of these groups, however, is thought to have achieved the status of true organized crime groups.

### **12.3.2.1 Background**

Today's outlaw motorcycle gangs are secretive and closely knit groups, selective about their membership. The gangs usually require that a member introduce a prospective recruit to the group. During a probationary period, the recruit's loyalty and willingness to commit crime are tested.

The symbol of membership in an outlaw motorcycle gang is its colors, usually a sleeveless denim or leather jacket with embroidered patches sewn on the back. The patches display a gang logo, sometimes slogans or initials. There may be rockers that identify the name of the gang member's most prized possession. They represent the foremost commitment of his life, his commitment to the gang and its criminal lifestyle.

Part of that lifestyle, common to most outlaw motorcycle gangs, is the members' outrageous treatment of the women who associate with them. Women are held to be less important than the gang itself and the gang member's motorcycle, and in some cases, women are used to generate income through prostitution and topless dancing, as well as for the transportation of drugs and weapons. Some gangs regard women as club property, available for the gratification of all the members. Others are considered the property of individual members.

Members of outlaw motorcycle gangs refer to themselves as one-percenters, in reference to the estimate by the American Motorcycle Association that outlaw motorcyclists comprise less than 1% of the motorcycling population.

### **12.3.2.2 Membership**

No firm figures of gang membership exist. The estimated membership is 3,100 in the four gangs:

Hell's Angels	800 (150 worldwide)
Outlaws	500
Bandidos	900
Pagans	900

Every gang has a coterie of associates, followers, and aspiring members. Some associates may include their conspirators in the manufacture and distribution of chemical drugs such as methamphetamines. It is estimated that there are 10 hangers-on for every full member. In 1985, the FBI listed 16 major crimes typical of outlaw motorcycle gangs; these include illegal drugs, murder, extortion, kidnapping, arson, robbery, bombings, and receiving stolen property.

### **12.3.2.3 Structure**

The leadership hierarchy of an outlaw motorcycle gang chapter generally consists of a president, vice president, secretary–treasurer, and sergeant of arms, usually elected for specific terms. However, informal leaders also emerge and often exercise more control than the elected officers. Chapters usually are gathered into regional groups, which support the national organization. The national organization is frequently headed by a mother club, which may be either an original chapter or a national ruling body in which each member supervises several chapters. The national president may be the actual leader or simply a spokesperson for the gang.

### **12.3.2.4 Hell's Angels**

The Hell's Angels' ties to La Cosa Nostra are well established. Informants have corroborated reports that members of the Cleveland chapter were involved in contract killings and drug trafficking for the Licavoli LCN family. Associations between members of the Hell's Angels and the Genovese crime family have been identified. In Troy, New York, Hell's Angels members are known to have a relationship with an associate of the Buffalino LCN family.

As is true of most organized crime groups, the Hell's Angels must launder their illicit income before it can be used legitimately. When income exceeds the immediate needs of the members, it is invested. The West Coast faction has been especially active in buying legitimate businesses, including motorcycle and automobile services, catering operations, bars and restaurants, antique stores, landscaping operations, and machine shops. The faction has recently acquired large parcels of acreage in the California gold country, a foothill area of the Sierra Nevada mountains, east of Sacramento. The gang's only discernible weakness is that its members are easily identified by their colors. However, some members are abandoning their outlaw image, wearing business suits and driving luxury cars, in essence becoming an outlaw motorcycle gang without motorcycles. The gang's strengths are many. It is institutionally wary of authority and uses sophisticated methods to protect itself from surveillance. Some clubhouses are fortified with elaborate electronic and physical security systems. Gang members do extensive background checks on prospective members, often using female associates who have been placed in positions with government services, and law enforcement agencies to assist them.

#### **12.3.2.5 *The Outlaws***

Founded in the late 1950s in the Chicago area, the Outlaws are an international group with chapters in Canada and Australia. The group's territory, which is divided into four or five regional areas, each with a president, runs mainly through the midwestern U.S. Outlaw territory includes Michigan, Illinois, western New York, Ohio, western Pennsylvania, and parts of Oklahoma, Arkansas, and Kentucky, and reaches into North Carolina, Georgia, and Florida. The Outlaws are intense rivals of the Hell's Angels in those areas where the two gangs' territories overlap. Like the Hell's Angels, the individual chapters of the Outlaws are independent and may cooperate with one another where that may be mutually beneficial. The Outlaws are considered less criminally sophisticated than some chapters of the Hell's Angels, but perhaps even more violent.

The Outlaws are heavily involved in the production and distribution of methamphetamines. The group's strength in the midwestern border states has allowed it to smuggle "Canadian Blue" valium into the U.S., while its chapters in Florida have made use of cocaine and marijuana smuggling outlets from South America.

The Outlaws have a record of involving their women associates in crime; their general treatment of those women, who are typically regarded as gang property, borders on slavery. Women are used in drug transactions to insulate members from arrest and are put to work as masseuses, prostitutes, and topless dancers in bars controlled by the gang. Some women are said to have been sold from one member to another. Besides trafficking in illegal drugs, the Outlaws are known to be involved in extortion, armed robbery, rape, mail fraud, auto theft, and witness intimidation. Their reputation for violence is strong. The Outlaws have had at least some contact with the LCN families. Clarence Michael Smith, a member of the Tampa, FL, chapter, was convicted of the murder of Robert Collins in New Orleans. Collins had testified against a nephew of Carlos Marcello, the LCN boss in New Orleans.

#### **12.3.2.6 *Bandidos***

The Hell's Angels and the Outlaws were already well-established gangs when Donald Chambers organized the Bandidos, also known as the Bandido Nation, in 1966 in Houston. The Bandidos are about a decade behind the Hell's Angels in their development but are quickly catching up. The mother chapter is in Corpus Christi, although the power base is

believed to be in Rapid City, SD. Its territories reach throughout the Southwest, through the Rocky Mountain region, and into Washington State. It has strength in Louisiana, Arkansas, and Mississippi.

The Bandidos are involved in a wide variety of crimes. A former female associate said that the Outlaws in Florida began supplying cocaine to the Bandidos as early as 1978. Many have been arrested for offenses involving dynamite and explosives. Massage parlors and escort services are among their favorite business enterprises.

Since 1979, the Bandidos have undergone several changes in leadership. The founding president, Donald Chambers, was convicted of a double murder and began serving a life term in 1979. Ronald Hodge succeeded him but stepped down in 1982. Leadership then passed to Alvin Frakes, who recently died of cancer, and the presidency may have reverted to Hodge.

### **12.3.2.7 *Pagans***

The Pagans have no international connections. They are considered second only to the Hell's Angels in criminal sophistication, and the strength of their internal structure is unmatched by any of the other three major gangs. Its territory is mainly in the Mid-Atlantic region. The original chapter was formed in Prince George's County, Maryland, in 1959. Since then, the mother chapter was moved to Marcus Hook, PA, and then to its current location of Suffolk County, New York.

The Pagans' mother chapter is unique among outlaw gangs because it functions like a board of directors or a ruling council. Each member of the mother chapter is responsible for a certain geographic area and has authority over chapters in that area, a system similar to La Cosa Nostra's national commission.

## **12.3.3 *Prison Gangs***

In the last 20 years, some groups in U.S. prisons have evolved into self-perpetuating criminal gangs. Several operate both in and out of prison and have taken one of the characteristics of true organized crime associations. Prison gangs engage in narcotics and weapons trafficking, extortion, robbery, and murder. Members released from prison remain in the gang, often providing support and enforcement for the organization inside.

The Department of Justice has identified 114 different gangs, not all of which are formally organized. A close examination of the 114 gangs yields 5 that appear to meet the criteria of an organized crime group: the Mexican Mafia, La Nuestra Familia, the Aryan Brotherhood, the Black Guerrilla Family, and the Texas Syndicate. All five operate in more than one state. In all five either murder or the drawing of blood is a prerequisite for membership.

### **12.3.3.1 *Mexican Mafia***

In 1957, members of the Mexican-American youth gangs were incarcerated at the Deuel Vocational Institute in Tracy, CA. They banded together, at first for self-protection, but soon began to control such illicit activities as homosexual prostitution, gambling, and narcotics. They called themselves the Mexican Mafia out of admiration for La Cosa Nostra. The group spread throughout California and into the federal prison system because of gang member transfers. The group recruited heavily from among the most dangerous and violent Mexican-American prisoners. A general and a few godfathers direct the activities

of captains, lieutenants, and soldados. Prospects must be sponsored for membership and must be approved by the vote of other members. They are required to kill without question, which gives the gang a constant pool of potential contract killers.

Since 1968, the Mexican Mafia has been in a constant feud with La Nuestra Familia, another Mexican-American gang whose members are primarily from rural areas of central California. The feud began when La Nuestra Familia (Our Family) attempted to take over heroin trafficking inside the California prison system. By 1972, 30 prisoners had died as a result of the feud.

The Mexican Mafia's allies in the feud have been the white supremacist prison group, the Aryan Brotherhood, with whom they cooperate in prison contract killings, as well as in robberies and illicit drug transactions on the outside.

#### **12.3.3.2 *La Nuestra Familia***

Originally formed in 1967 as a Latin cultural organization in Soledad prison, La Nuestra Familia began to sell protection to others that had been victimized by the Mexican Mafia. Soon the group moved into the extortion rackets that their rivals had monopolized. In 1975, the gang began establishing regiments outside prison, using Fresno County, California, as a home base.

The gang's organizational structure consists of a single general with supreme power, captains, lieutenants, and soldados. Rank is usually achieved by the number of hits in which a member is involved.

La Nuestra Familia is allied closely with the Black Guerrilla Family.

#### **12.3.3.3 *Aryan Brotherhood***

San Quentin prison in California was the origin of the group first known as the Diamond Tooth Gang, now the Aryan Brotherhood, a white, Nazi-oriented gang dominated by members and associates of outlaw motorcycle gangs. The Aryan Brotherhood (sometimes known as the A-B) has branches in prisons around the country, but it seems most active in state prisons in California, Arizona, Wisconsin, and Idaho, and throughout the federal prison system.

Its typical crimes include robberies and extortion of inmates' families outside prison, as well as offenses commonly associated within the walls: extortion, protection schemes, and crimes of intimidation and violence.

A commission and a governing council rule the group; members advance in the ranks through acts of violence.

#### **12.3.3.4 *Black Guerrilla Family***

George Jackson, a former member of the Black Panther Party, founded the Black Guerrilla Family in San Quentin in 1966. It is the most politically oriented of the five major prison gangs, and often follows a Maoist philosophy.

The goal of the gang is cultural unity and the protection of black prison inmates. Many members formerly belonged to the Black Liberation Army, the underground organization responsible for the October 1981 robbery of a Brinks armored truck, during which a guard and two New York police officers were killed. New recruits for the prison organization frequently have belonged to black street gangs. They join the prison gang to share in its criminal profits, which has led to a split between a political faction and the moneymaking faction.

The gang's ruling structure consists of a single leader (known as a chairman or supreme commander), a central committee, and a very loose ranking of soldiers.

#### **12.3.3.5 *The Texas Syndicate***

A third major Mexican-American prison gang is the Texas Syndicate. It was formed in California's Folsom prison in 1974. Its founders were all from Texas. They banded together for mutual protection and soon became known for their swift retaliation against any opposition. As gang members were released from California, they returned to their home state. Many were soon rearrested and imprisoned in Texas. Today, the Texas Syndicate is the largest gang in that state's prison system.

The gang is active in drug trafficking, contract murders, assaults, and intimidation within the prison. Members take a life oath and are more secretive than most prison gangs.

Under the leader is a chain of command similar to that of most prison gangs. The Texas Syndicate is known to be exceptionally violent, frequently assaulting or killing non-members and prison staff. They have no working relationship with other prison gangs.

### **12.3.4 Chinese Organized Crime**

Secret Chinese criminal societies known as Triads were originally formed as resistance groups to the Ching Dynasty, which ruled China from the early 17th century until 1912. Triads flourished in Hong Kong and Taiwan through the 1950s and 1960s, controlling many important police posts in Hong Kong until the early 1970s.

Now members of Triads in Hong Kong and Taiwan are living in the U.S. They have formed Triad-like crime groups in major American cities and are active in drug trafficking, illegal gambling, and loan-sharking, among other sophisticated criminal offenses. They operate through youth gangs, under the direction of established Chinese businessmen and community leaders. They cooperate with LCN families and maintain close ties to criminal associates in Hong Kong, Taiwan, Thailand, and the People's Republic of China.

#### **12.3.4.1 *History and Background***

With the end of the Ching Dynasty, Dr. Sun Yat Sen, who had been a Triad member, called for the disbanding of the secret societies in 1912. Many Nationalists heeded Sun's appeal; some moved into government posts. Criminal elements filled the vacated positions in the Triads.

General Chiang Kai Shek, also a former Triad member, enlisted a number of the groups in his fight against Communism. All Triads were politically oriented. Many took advantage of lawless conditions in China to expand their organized criminal activities, and some Triads made open agreements with Japanese occupational forces in order to continue their illegal enterprises.

Many Triad members fled China in 1949 after the collapse of the Nationalist government. A large group followed Chiang to Taiwan; others sought refuge in Hong Kong, reinforcing an already strong Triad presence in that British colony. When Kuomintang and Nationalist armies retreated to Burma and Thailand, they established an important foothold in the Golden Triangle and began to supply the Hong Kong Triads with opium and heroin. That connection continues today. The drugs are now shipped out of Hong Kong to the U.S., Canada, Australia, and Northern Europe.



Triad members in Hong Kong developed extortion rackets, illegal gambling, drug trafficking, prostitution, loan-sharking, and other criminal trades. Despite frequent and bloody territorial battles, they thrived almost unhindered after compromising and corrupting police and local officials. During an anticorruption drive in 1970, five former sergeants in the Hong Kong police, known as the Five Dragons, fled the country, carrying as much as \$1 million each. One of the associates of the Five Dragons was Eddie Chan, now a businessman in New York's Chinatown and a leader of the On Leong Tong there.

Triads based in Taiwan were allowed to continue operating on the condition that they support the anti-Communist stand of General Chiang and his exile government. Thus, Taiwan-based Triads and their affiliates in other countries are known as right-hand groups, a political reference. They have been involved in political intelligence gathering and, at least once in this country, in the assassination of political opponents.

Left-hand Triads, many based in Hong Kong, maintain working relationships within the People's Republic of China. For example, the Kung Lok Triad, a Hong Kong group, has ties to officials of the People's Republic of China.

After more than 200 years of an underground existence, the Triads developed an intricate secret structure, with arcane designations and ceremonies, many of which survive today. Various offices in the organization are identified by numbers, each beginning with the digit 4, a reference to the ancient Chinese belief that the world is surrounded by four seas. The leader of a Triad group is given number 489. Second-tier leaders, each with specific duties, are known by the numbers 432 (messenger or liaison) and 438 (incense master or recruiter). Lower-ranking officers are designated as 426 (organizer or enforcer) or 415 (an expert on administration and finance). Ordinary members are given the number 49. Initiation rituals include the beheading of a chicken (intimating the fate of a member who betrays the group), the mingling of blood by members and initiates, and the recitation of 36 loyal oaths. The Los Angeles Police Department found a code of ethics during one of its investigations. This code of ethics was translated to read as follows:

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### **Members' Code of Ethics**

1. Harmony with the people is the first priority. We have to establish good social and personal connections so as not to create enemies.
  2. We have to seek special favors and help from uncommitted gang members by emphasizing our relationships with outside people.
  3. Gambling is our main financial source.
  4. Do not take it upon yourself to start things and make decisions you are not authorized to make.
  5. Everyone has their assigned responsibility. Do not create confusion.
  6. We must not divulge our plans and affairs to outsiders, e.g., wives, girlfriends, etc.
  7. We have to be united with all our brothers and obey elder brothers' orders.
  8. All money earned outside the group must be turned over to the group. You must not keep any of it for yourself.
  9. When targeting wealthy prospects, do not act hastily. Furthermore, do not harass or threaten them.
  10. If anything unexpected happens, do not abandon your brothers. If arrested, shoulder all responsibility and blame. Do not involve your brothers.
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### **12.3.4.2 *Triad Groups and Tongs***

As early as the 19th century, Chinese immigrants in America had formed benevolent associations known as tongs, a term that loosely means “meeting hall.” Today many tongs are national organizations with chapters in cities that have large Chinese communities. Tongs function as business associations, ethnic societies, and centers of local politics.

However, there is a sinister aspect of many tongs. Several of the largest and most respected are used as fronts for vicious Chinese organized crime groups that prey mainly on Chinese immigrants and Chinese Americans. Tong members direct gang enterprises that include extortion, illegal gambling, narcotics trafficking, robbery, and protection schemes for prostitution and pornography. Among the prominent tongs associated with Chinese organized crime are the On Leong Tong, headquartered in New York; the Hip Sing, also New York based; and the Hop Sing, with headquarters and operations on the West Coast.

The tong members who supervise Chinese criminal groups frequently are Triad members with Triad designations. The 426 is the street-level leader of the gang. Gang members are Chinese males in their late teens and 20s. They are often chosen specifically for their youth and malleability, and on the further assumption that the justice system is lenient with young offenders whose criminal records, in this country, are negligible or nonexistent.

A secret commission witness identified as 426, designating his position as captain and enforcer in a Chinese crime gang in the U.S., described in a deposition how, as a teenager, he had been inducted into a Triad group while in Hong Kong. He told how he left Hong Kong to avoid prosecution and came to North America where he eventually jointed a Triad chapter. Later he was active in a New York group that included Triad members among its leadership. The gang functioned as a criminal arm of a major national tong and was involved in narcotics, extortion, and murder, often drawing on its ties with a Triad group in Hong Kong. He described international collaboration between branches of Triad groups on such matters as intimidation of witnesses, assassinations, and the importation of heroin from sources in the Golden Triangle, sometimes through mainland China.

### **12.3.4.3 *Chinese Crime Groups in New York***

Chan Tse-Chiu, also known as Eddie Chan, is president of the On Leong Tong in New York. He has been president of the national organization, which has chapters throughout the U.S.; currently, he is its honorary national president. Chan is also a former Hong Kong police sergeant who served in the post during the era of the Five Dragons. According to several sources, he is also the supervisor of a street gang known as the Ghost Shadows, a national crime group with chapters in several cities and with intimate ties to the On Leong Tong.

In New York and elsewhere, the Ghost Shadows engage in narcotics trafficking, loan-sharking, illegal gambling, and extortion rackets. At one time the gang was led by Nicky Louie, whose influence in the group was such that he attempted to wrest control from Eddie Chan. Loyalists from Ghost Shadows groups in Boston and Chicago sided with the Louie faction in the gang war that resulted when Chan ordered the murder of his rival. Eventually, Louie and his coterie fled to Chicago. Eight assassins from the Chan faction of the New York Ghost Shadows were dispatched to Chicago; a car they used was eventually traced back to the rental account of On Leong Tong officials in Chicago. Louie was critically wounded in an ambush at On Leon Tong headquarters in Chicago; he survived, but his driver was killed.

As a part of a negotiated settlement, Nicky Louie was allowed to retire. Eddie Chan and the On Leong Tong retained control of the Ghost Shadows and their criminal enterprises.

The other major association in New York's Chinatown is the Hip Sing Tong, located on Pell Street. Its leader is 75-year-old Feilo Chat, known as Benny Ong, Uncle Seven, or Uncle Benny. Ong is an immigrant and gang member who served 17 years for a homicide and was released in 1952. Today he is among the most visible members of the Chinese community in New York, with significant business holdings throughout Manhattan.

The criminal arm of the Hip Sing Tong is the Flying Dragons, whose activities include extortion, illegal gambling, and narcotics trafficking. A truce with the On Leong Tong in the 1960s secured Hip Sing's hold on Pell Street and the nearby area.

Another Chinese gang is the Fuk Ching. They are regarded as one of the most powerful and have transnational operations. They are extensively involved in human smuggling and kidnapping. They have dominance in the Fujian Province. This is where they get their source of migrants to smuggle to the U.S. and Canada. It is this human smuggling that has caught law enforcement's attention on both the East and West Coasts of the U.S. and Canada. Ships with loads of illegal immigrants have been seized in recent years.

Most Chinese business owners comply with gang extortion demands because compliance is easier and less risky than resistance. Gang affiliation with a tong gives them a degree of acceptability in the neighborhoods. Chinese who live in the neighborhoods are fully aware of the gangs. Chinese businessmen would prefer tougher gang punishment, the reinstatement of the death penalty, and the deportation of chronic Chinese criminals. They want more Chinese police officers in the neighborhoods. Chinese gangs are not involved in political terrorism either abroad or at home. In the U.S., they have not been able to corrupt police or judges.

#### ***12.3.4.4 Violence among Chinese Crime Groups***

In New York, rivalries among newer groups have resulted in three massacres of associations in the early 1980s. On December 23, 1983, members of the White Tiger's group were ambushed at a bar. Eleven people, most of them White Tiger's recruits, were killed and wounded. On September 4, 1977, at the Golden Dragon restaurant in San Francisco's Chinatown, five innocent people were murdered. The restaurant was a favorite of the gang known as the Hop Sing Boys. They killed 5 people and seriously wounded 11 others. None of the victims were gang members, since the Wah Ching and Hop Sing Boys had fled when they noticed the gunmen approaching.

In addition to New York, Chicago, and San Francisco, Chinese organized crime groups have a strong presence in Monterey Park, CA, Boston, and many other U.S. cities.

#### ***12.3.4.5 The Hong Kong Summit***

During the early 1980s, the principal leaders of Chinese organized crime in North America, or their representatives, met in Hong Kong to discuss a possible détente between major rival groups. Those in attendance included Kis Jai (Peter Chin), leader of the New York Ghost Shadows under Eddie Chan; Vincent Jew, West Coast leader of the Wah Ching; Danny Mo (Danny Mo Sui Chen), the operational leader of the Kung Lok Triad in Canada; and Stephen Tse, leader of the Ping On gang from Boston, who is also believed to be a former associate of the 14K Triad in Hong Kong.

The meeting resulted in recognition of territories and an agreement to assist one another when necessary. The participants “burned the yellow paper,” a ritual that symbolizes brotherhood and the start of a new venture. Later, the principals formed a joint venture, the Oriental Arts Promotion Company, by which they have attempted to monopolize the U.S. bookings of Chinese-speaking entertainers from Hong Kong and Taiwan.

In 1998, a federal grand jury charged 21 gang members in drug trafficking and money laundering after a 13-month investigation called Operation Hardtac. Arrests were made in New York, Philadelphia, Atlanta, and Hong Kong. The Chinese gang was controlled by Weng Keek Hoo. He was previously deported to Hong Kong. The Chinese gang imported heroin from Southeast Asia to Vancouver, Canada. The drugs went to Toronto before being smuggled into the U.S.

#### **12.3.4.6 *Canada: The Kung Lok Triad***

The international scope of the Chinese crime gangs is evident in the Canadian chapter of the Hong Kong-based Kung Lok Triad. This group undertakes the standard range of crimes against Chinese Canadians and is considered active in Toronto, Montreal, Ottawa, Vancouver, Hamilton, and other metropolitan areas. The Kung Lok is a more traditional Triad establishment. Its members in Canada undergo the same ritual initiation as those in Hong Kong.

There is constant traffic of Kung Lok members among Canada, the U.S., and various Caribbean locations, particularly Santo Domingo. In the early 1980s, Kung Lok established an illegal gambling house on Division Street in New York through an agreement with the Hip Song and the On Leong. Lau Wing Kui, deported leader of Kung Lok in Canada, owns an interest in at least one casino in Santo Domingo and has interests in several other Hong Kong gambling establishments. It is believed that the Kung Lok members carry large sums of cash out of Canada to be laundered at the Santo Domingo casino before the money is brought to the U.S. Kung Lok has members in the U.K. and Europe who act on orders of the Hong Kong leadership, giving them a worldwide capability to intimidate witnesses, directly or through threats against the witness’s family, in any area where Kung Lok members operate.

#### **12.3.5 *Vietnamese Gangs***

In the first 8 years after the Communist victory in Vietnam, about 650,000 Indochinese emigrated to the U.S. Among them were criminals with backgrounds in drug trafficking, extortion, and prostitution. Many criminals assumed the identities of deceased Vietnamese who had no arrest records.

Small bands of these criminal refugees formed in resettlement camps. Later, they formed gangs in Vietnamese communities around the U.S. There are seven cities in California with active Vietnamese gangs, four gangs in Texas, three in Louisiana, two in Alabama, and one in each of the following states: Washington, Colorado, Florida, Massachusetts, New York, Pennsylvania, Oregon, Virginia, and Hawaii.

In some cases, the groups are little more than street gangs. Others conduct sophisticated criminal schemes, extortion, gambling, and drug trafficking that require organization and discipline. Police report that there is at least informal communication between gangs. Also, they are extremely mobile. There is evidence of networking among gangs, i.e., Vietnamese fugitives in California finding sanctuary in New Orleans. Vietnamese gangs are known to cooperate with other Asian crime groups.

Generally, Vietnamese gangs confine themselves to communities of other Vietnamese who are particularly susceptible to extortion. The immigrant victims are reluctant to testify because they do not believe police will protect them from retribution.

### 12.3.6 Japanese Organized Crime

With membership as high as 110,000 in as many as 2,500 associated gangs, the Japanese Yakuza may be the largest organized criminal group in the world. The Yakuza originated in 16th- and 17th-century Japan, where feudal lords maintained stables of Samurai warriors. Stronger national government in Japan subsequently made many regional warriors superfluous, and they allied themselves both with the ruling Shogunate and with dissident villages. Eventually, the vagabond warriors became known as Yakuza, a gambling term for numbers that are worthless or losers, 8 9 3. The name evolved into an expression for “outlaw,” with a connotation of respect based on fear. Through the next three centuries, the status of the Yakuza fluctuated, depending on the strength of the national government.

Immediately after World War II, immense social and economic changes in Japan meant opportunity for organized crime, particularly in black markets. The Yakuza prospered, adding pornography, narcotics, and systematic racketeering to their illicit enterprises, while expanding into entertainment, sports, labor unions, and corporate affairs. Their enforcement tactics became brutal; police and media in Japan referred to Yakuza as Boryokudan, or “violent gang.” Many street gangs associated with the Yakuza began to mimic American outlaw motorcycle gangs. Others imitated the dress and style of Prohibition-era gangsters, as interpreted by U.S. moviemakers.

Japanese police designate seven major groups of Yakuza. The largest is Yamaguchi Gumi, with an estimated membership of 10,000, which has a hierarchical structure resembling that of the LCN family in this country. There is a single Kaicho (chairman), who has advisors without command authority. Wakato control several deputies, and beneath them are lieutenants who manage numerous soldiers, or wakai shu.

The other six major groups, with more elaborate structures, are confederations of smaller gangs that have combined to increase their power. These alliances control criminal activities in assigned territories. The most powerful and the most important rival of Yamaguchi Gumi is the alliance known as Sumiyoshi Rengo, with an estimated strength of 8,000 to 15,000 members.

Whatever the internal arrangement of the organization, a Yakuza member’s status is determined by his efficiency as an earner, who passes profits to his higher-ups. The more elevated his position, the more money he receives from below, although his obligations remain to those still above him. It is a highly competitive system calculated to maintain pressures for production; Yakuza members, particularly those in the lower echelons, are encouraged to find new enterprises with which to satisfy the constant demand from above. Loyalty to superiors is considered paramount. A Yakuza member who has angered his supervisor may apologize by amputating a finger or finger joint from his own hand, then presenting it to the offended party as a gesture of sincerity.

The Yakuza groups are active in drug trafficking, primarily smuggling amphetamines, from the U.S. into Japan. They also supply a lucrative Japanese market for firearms, which are strictly regulated in that nation. A handgun that sells for \$100 to \$200 here may be worth \$1,000 in Japan, and a single round of ammunition might sell for \$12 to \$15.

Yakuza enforcers are sometimes used by the boards of large corporations in Japan to keep order at open stockholder meetings, a practice known as sokaiya. Strong-arm gang members discourage potentially embarrassing questions by stockholders. Also, the reverse occurs when a minority faction, perhaps affiliated with Yakuza interests, wishes to intimidate the board or majority. Physical violence is not uncommon.

### **12.3.6.1 *Yakuza in the U.S.***

The Yakuza has been mainly involved in obtaining contraband for shipment to Japan. However, recent intelligence has shown that they are involved with factions of the LCN in East Coast gambling operations catering to wealthy Japanese businessmen. On the West Coast, they are involved in illegal gambling and prostitution. For at least 20 years, the Yakuza members have invested illegally earned profits in U.S. businesses. Recently, Yakuza interests have increased in legitimate businesses, massage parlors, and pornography. Three Yakuza groups, the Yamaguchi Gumi, Sumiyoshi Rengo, and Toa Taiu Jigyo Kumiai, are currently active in southern California. In recent years, the Yakuza has bought shares of major corporations and has started the function of sokaiya, corporate intimidation. Also, the Yakuza has infiltrated legitimate businesses. In so doing, it has employed business practices that American companies cannot because of fear of being prosecuted for antitrust violations or illegal business practices. However, the Yakuza have been getting away with this because prosecutors have not developed their cases to the extent necessary to obtain a conviction.

**12.3.6.1.1 Asian Characteristics.** Asians, citizens and criminals, have some common characteristics that a fraud examiner should be aware of:

1. **Authority.** Asians do not view law enforcement as servants of the community. In Asia, law enforcement was set up to protect rulers and their parties, not to protect and serve the community. Asian citizens are reluctant to report crimes when they become victims. This is due to no belief in or understanding of the criminal justice system, as well as fear of retaliation by the criminals. Many Asians feel that the American justice system does not impose punishment to fit the crime.
2. **Asset hiding.** Asians have created their own underground currency by trading in commodities. They invest their cash in gold and precious stones, particularly diamonds, rubies, and jade. They prefer to keep their valuables in their homes or businesses rather than use banking services. They invest heavily in taels, since they can be easily hid and exchanged. (A tael is a standard Chinese measurement that measures  $3 \frac{3}{4} \times 1 \frac{1}{2}$  inches and weighs 1 troy ounce. It is 24 carats, and gold prices determine its market value.) Asian immigrants will invest in taels until they have enough to acquire their own business. Asians will launder their illegal profits by investing in legitimate businesses. This underground currency helps them avoid paper trails and evade taxes. Asian immigrants will work under the table and even collect public subsistence while accumulating their wealth.
3. **Credit unions.** Asians have organized together to form an informal credit union. These self-help programs consist of 10 to 20 people who are mostly women. They are organized for definite periods and have regularly scheduled meetings. Members are required to invest specific amounts of money at each meeting. When cash holdings are ample, members bid for the cash. The highest bidder receives the

funds. The bidder must repay the loan with interest over a specific time. This allows the funds to be available to another member. These informal credit unions have no official recognition and usually involve large amounts of cash. They can also lend themselves to the organizer to rig bids or abscond with the cash. Asian credit unions are known by the following names:

HUI	Vietnamese
GAE	Korean
CHO WUI	Chinese
TANA-MOSHI	Japanese

4. **Corruption.** Most Asians believe that all government officials have a price. Payoffs in Asian countries are very common. It is a way of life and is considered to be an additional tax by Asian businessmen. Payments begin small and build up from there. They start out as free lunches and build up to cash payments from the cash register. Any government official who accepts any gifts will soon learn that the Asian businessman has announced in the community that he has a “friend downtown” that can cut through red tape or can provide protection.

**WARNING:** Government officials should never accept any gifts or gratuities from any Asian, not even a cup of coffee or tea.

**12.3.6.1.2 Asian Crime Trends.** There are some obvious trends with Asian criminal enterprises. First, they cooperate with other ethnic and racial heritage lines. It is known that they cooperate with various families of the LCN in New York, Chicago, and Philadelphia. They are becoming more structured in a hierarchical fashion so they can be competitive. Their operations have become more globalized. They are engaging in more white-collar crimes and are commingling their illegal activities with legitimate business ventures. They are becoming more mobile and can adapt easily to change. Many Asians are becoming multilingual and have financial capabilities. In some cases, they have commercialized their criminal activities by being viewed as business firms of various sizes, from small operations to large corporations.

### 12.3.7 Cuban Organized Crime

Since 1959, over 1 million Cuban refugees have arrived in the U.S. Most have come seeking political freedom and the opportunity to build productive lives. But from the first wave of refugees in 1959 to the latest, a criminal minority of Cubans has found ground for illegal enterprises that are as ambitious and sophisticated as any before seen in this country.

There have been three periods of mass Cuban emigration to the U.S.: (1) immediately before and after the fall of the Batista regime until Fidel Castro halted emigration in 1959; (2) between 1965 and 1972 during the Camarioca boat lift “freedom flotilla,” prompting the Family Reunification Program, under which more than 250,000 Cubans migrated to the U.S.; and (3) between April 21 and November 10, 1980, during a boat lift from Mariel Harbor, bringing nearly 125,000 new Cuban refugees to the U.S. By far the greatest concentration of criminals was in the Mariel Harbor exodus, with nearly 2% of those arriving in the U.S. having been classified as prostitutes, criminals, drug addicts, or vagrants. Because of this minority, the term *Marielito* has come to imply a criminal or undesirable; it refers specifically to the career criminals who left Cuba during the 1980 boat lift.

There are differences between the criminals who immigrated in the first two waves and those who came in the 1980 Mariel boat lift. Criminal syndicates founded by the earlier arrivals tend to be more extensive, more highly structured, and more closely associated with other criminal groups, especially La Cosa Nostra, than those of the Marielitos. While the established groups have partly built their criminal fortunes on less violent crimes, mainly on forms of gambling, the newcomers have shown a propensity for killings, kidnapping, and street crime. The differences may partly be attributed to the fact that for more than 20 years, while early arrivals were busy establishing themselves, the later arrivals were in primitive prisons and hospitals and in a brutal underworld subculture. There is evidence that the established Cuban syndicates have begun using Marielitos in their criminal enterprises, so these distinctions may soon become less clear. Nevertheless, the present differences between them are great enough that the two groups are treated separately in this book.

There are two established groups in the U.S.; one is known as La Compania, or the Corporation, the other group as Garielito. La Compania is involved in drug trafficking and gambling. Illegal gambling, particularly bolita or policy lotteries, is widely accepted by Cubans. While La Cosa Nostra controls most lotteries and bookmaking in Cuban communities, many of those operations have come under the control of the Cuban groups.

The Corporation is the most prominent emerging Cuban gambling cartel and is headed by Jose Miguel Battle. This group's annual profit was estimated to be between \$45 and \$100 million in 1984. Battle, known as Jose Miguel Vargas, Miguel Blasquez, Rafael Franco Tesona, Don Miguel, and El Gordon, was a soldier in the Batista army and a Havana policeman until the fall of the Batista regime. After Cuba collapsed, Battle fled to Miami and joined the Brigade 2506, the Bay of Pigs landing group. After the failed invasion, Battle returned to Miami and founded the first Cuban-controlled gambling organization. The group grew through police and political corruption.

In the late 1960s, Battle moved his operations to New York City, Union City, with the help of Joseph Zicarelli and Santo Trafficante. He began to take over existing operations there by violent means.

By the early 1970s, Battle's group collected bets from most of the Hispanic bodegas and bars in New York and New Jersey. Zicarelli and James Napoli, soldiers of the Genovese crime family, helped negotiate a settlement by which Battle agreed to pay a percentage of his earnings to La Cosa Nostra and lay off some of his betting action. The Corporation's records show that the group grosses in excess of \$2 million on a weekly basis. Battle and the Corporation have amassed assets valued at several hundred million dollars. The Corporation owns or controls Union Management and Mortgage Company, the Union Finance Company, the Union Financial Research Company, Inc., Union Travel and Tours, and El Zapotal Realty, Inc., all in South Florida.

During the early 1970s, Battle was convicted on Rico gambling charges. He fled to Madrid, Spain after receiving an 18-month sentence. He served 13 months in prison after he was arrested trying to re-enter the United States by way of Costa Rica. In 1977, Battle received a prison sentence totaling 34 years for concealed weapon charges and the murder of a former associate, Ernestico Torres. An appeal court overturned the conviction, but Battle later pleaded guilty to murder conspiracy in exchange for a sentence of time served, 2 years. On March 18, 2004, Battle was arrested on racketeering charges along with 20 other members. He is currently awaiting trial. Battle is 74 years old and in bad health.



In 1982, Battle and several key associates, including Abraham Rydz, moved to Florida. Battle, his wife, son, and Rydz bought various real estate properties totaling \$1,115,000, for which they paid \$805,000 in cash. On April 8, 1983, New York Port Authority Police found \$439,000 cash in luggage belonging to Rydz and Battle's son, Jose Battle, Jr., after two men resisted search of their carry-on baggage while boarding a flight to Miami. On December 3, 1984, British Customs authorities at Heathrow Airport in London detained several associates of the Corporation, including Humberto Davila Torres, whose itinerary included stops in the Bahamas, Switzerland, and Spain, with a return to Miami; between them they possessed \$450,000 in U.S. currency. In all, cash seizures from members of the groups have totaled about \$43 million.

The enormous cash flow is laundered through a complex web of influence in mortgage and lending companies. The Capitol National Bank in Manhattan received huge deposits of the Corporation's gambling receipts. The bank was also the largest redeemer of food stamps from the North New Jersey bars.

A task force in June 1985 arrested 16 people, including 11 present or former Puerto Rican bank officials. Operation Greenback in Puerto Rico uncovered a scheme by members of the Corporation to launder hidden income by the purchase of winning tickets in the legal Puerto Rican lottery. Members of the Corporation would privately buy the winning ticket from the owner, paying a premium price in dirty cash from the gambling operation. A \$125,000 ticket, for example, would be bought for \$150,000. The money then would be deposited without being traced to the source.

La Compania was formed in the early 1960s. Its primary purpose was to import cocaine, heroin, and marijuana. The group is estimated to have about 125 members, with a connecting group in Los Angeles. La Compania has branches in New York, Las Vegas, Texas, Arizona, New Jersey, and Tijuana. After more than 20 years, the Cuban group has produced large amounts of capital, which is invested in businesses, real estate, and banks.

### **12.3.7.1 *Marielito Crime Gangs***

The Mariel boat lift had its genesis on April 1, 1980, when a small band of Cubans in a city bus attempted to gain political asylum by crashing the gates of the Peruvian Embassy. One Cuban guard at the gate accidentally killed another guard while trying to stop the bus. Fidel Castro was enraged and publicly announced the removal of all guards from the gates. Within days, over 10,000 people had crowded into the embassy grounds, requesting political asylum. Eventually, Castro allowed them to be flown out of the country. This group and the majority of those who followed later included primarily decent and working-class people who genuinely sought liberty. Castro proclaimed the refugees to be the scum of Cuban society. When the exodus continued, he tried to prove his description by forcibly including convicts, hard-core criminals, prostitutes, and the mentally ill among those who left by boat from Mariel.

The career criminals who came to the U.S. during the Mariel boat lift are commonly known as Marielitos. Some have formed crime gangs, including large drug trafficking rings and some formally organized groups with operations in several different cities. They have cooperated with longer-established Cuban crime groups as collectors and enforcers in drug and gambling operations. Gangs of Marielitos have assisted Colombian drug smuggling organizations, and at least once, the LCN family has used a Marielito as a hired killer.

There has been an unprecedented wave of violent crime among Cubans since their arrival in this country. Increased homicide rates in several locales are directly attributable to Mariel criminals. Homicide rates in Hialeah, FL, increased from 12 to 43 from 1980 to 1981; most involved Marielitos.

Marielitos are involved in robbery, burglary, rape, counterfeiting, bookmaking, auto theft, shoplifting, extortion, and prostitution, but are mostly involved in cocaine trafficking and murders.

The profile of the Mariel career criminal is specific and unique. He is generally male, in his 30s, poorly educated, superstitious, with a good physique and poor personal hygiene. Many are former military conscripts who have seen service in Angola or Central America; thus, there is a good chance that the Marielito is familiar with automatic weapons and knowledgeable in guerrilla warfare. Commonly, the Marielito's body is marked with scars, which he often reveres as emblems of battle. Some are self-inflicted or the result of religious rituals.

Over 90% of the convicted Mariel refugees have a tattoo somewhere on their bodies. In Cuban society, tattoos are a sign of disgrace. Mariel tattoos are often intricate, displaying patron saints, names, words, or arcane symbols. A display of five dots on the web of the hand, between the thumb and forefinger, identifies a pickpocket or delinquent.

The Marielitos are members of Afro-Cuban religious cults, which explains the aberrant behavior. One cult is called Santeria, which is imbued with qualities of Christian saints and various African deities. Its antithesis is the practice of Palo Mayombe. Criminals honor the god of hunting, Ochosi, who is believed to guarantee freedom from incarceration, which leads them to take risks or perform acts they would normally avoid.

Another Afro-Cuban sect is the Abaquá cult, with origins in Cuban prisons. It is considered as much a fraternal order as a religious society. Members wear an arrow-shaped tattoo in the web of the hand.

In 5 years, the Marielitos formed two large gangs. The Abaquá cult and the Mariel Bandidos are both located in the Washington, D.C., area and have memberships as high as 500 to 1,000. Other groups are located in Las Vegas, New York, and Los Angeles. Intermediate-size groups have appeared in other states, primarily dealing in illicit narcotics. They form small, loosely structured, highly mobile gangs that disband after the criminal task has been completed. The members then drift to other cities. Investigation has been difficult because the gangs are so fluid and difficult to identify. The new gangs have earned a share in drug trafficking. They are crude in their approach, but established crime groups may supply the necessary sophistication.

### **12.3.8 Colombian Cocaine Cartels**

About 75% of the cocaine consumed in the U.S. comes from Colombia. There are at least 20 Colombian drug rings. These rings are centered in two major cities: Medellín and Cali. Most of the drug rings are centered in Medellín. Medellín is the second largest city in Colombia. Their members and workers handle every phase of production: manufacture, distribution, finance, and security. Each function is separate from the other; thus, the loss of one member or group does not threaten the entire group. The rings can quickly adapt to outside pressure while continuing to pursue the goal of maximum production for maximum profit. The rings' influence is broad. They use foreign banks and tax havens in the Caribbean and Europe. Colombian traffickers are ruthless in pursuit of profit and use

violence to protect their enterprises. The cocaine trade in South America is in a state of flux. The Medellin cartel has been hit hard by aggressive enforcement and interdiction strategy, and is in a state of disarray and confusion. Some smaller traffickers have collapsed or moved their operations to neighboring countries. Concentration of resources by the Colombian government upon the Medellin cartel, however, has allowed other groups to consolidate and grab a larger share of the market. It is estimated that the Cali cartel has taken over 70 to 80% of the Medellin cartel's business. The Colombian government has indicted many bankers and lawyers in recent years for money laundering cartel profits. The best-known case is Banco de Occident, which is based in the western city of Cali, where the bank was indicted for laundering millions for the late drug kingpin Gonzalo Rodriguez Gacha. The U.S. Drug Enforcement Agency found Gacha's bank records in an oil drum. Fabio Ochoa and his sons have been indicted in the U.S. Ochoa, after the Colombian government indictments, built his own jail. He stayed in the jail for awhile, then later escaped. Later on, he was cornered by the Colombian police and killed. Ochoa was considered to be one of the wealthiest men in the world. He lived a very lavish lifestyle. The Colombian government found that Ochoa had his own army of mercenaries, which were trained by former Israeli military. Prior to the Colombian government crackdown with U.S. aid, the drug lords in Medellin controlled most of the countryside. It is believed that the Communist rebels in the country tried to blackmail the drug lords by kidnapping family members. This backfired on them. The drug lords had more wealth and firepower. This later resulted in the Communist rebels and drug lords forming an alliance. The Colombian drug lords have expanded their operations to other surrounding countries. They have established sophisticated communication and transportation networks from South America to the U.S. and Europe.

The Colombian police with the cooperation of U.S. authorities has arrested or killed top-level Medellin drug lords. With the demise of the Medellin drug lords, the Cali cartel has taken over some of the Medellin operations. The top man in the Cali cartel is Gilberto Rodriguez Orejuela, nicknamed "the chess player." In the DEA investigation Operation Green Ice, the Cali drug cartels were involved with the Sicilian Mafia. The Italian National Police found that the Cali drug cartels were shipping cocaine to Sicilian Mafia for distribution through Italy and Europe. Seven top-ranking financial managers for the Cali cartel were lured to the U.S., Costa Rica, and Italy, where they were arrested. The Colombian National Police raided the financial offices of Orejuela.

### **12.3.9 Mexican Mafia**

The Mexicans saw the rise of the Colombian drug cartels and the money they were generating from drug trafficking and wanted a piece of the action. They started getting into drug trafficking in the 1970s. At first, they were smuggling the drugs to the U.S. for the Colombians. Eventually, they began to raise marijuana, cocaine, and heroin and transport them to the U.S. Mexico is currently the number one supplier of marijuana to the U.S. Currently, it is estimated that 70% of these illegal drugs comes from or through Mexico. The organizations that control drug production and shipment, and related money laundering and criminal activities, are powerful. They are well organized and possess substantial financial resources. They have corrupted police, the military, lawyers, and judges in Mexico.

Like Sicily, the Mexican government has been under siege by drug trafficking organizations. They have murdered law enforcement officials, lawyers, politicians, and innocent citizens. Most drug violence is centered on retaliatory killings of individual drug traffickers. They are known for kidnapping victims and later murdering them. Their remains are dumped along roadsides or isolated desert areas. Mexican drug traffickers are known for heinous acts of torture, including severe beatings, burnings, and severing body parts. Most of the violence has centered in the states of Baja California, Nuevo Leon, Tamaulipas, and Sinaloa. This is due to producing and transit regions by rival groups. The Mexican press reported 249 violent deaths in Tijuana, Baja California, in 2002.

The most prominent Mexican drug trafficking organizations are:

1. **Arellano-Felix Organization.** This is one of the most powerful drug trafficking organizations in Mexico. It operates mostly in Tijuana and between San Diego and Los Angeles. Its enforcer, Ramon Arellano-Felix, died on February 10, 2002. The chief of operations, Benjamin Arellano-Felix, was arrested on March 9, 2002. The organization still continues to operate.
2. **Vicente Carrillo-Fuentes Organization.** Since the death of Amado Carrillo-Fuentes in July 1997, the organization has remained intact with key lieutenants retaining control of specific geographical areas. The lieutenants are Amado's brother Vicente Carrillo-Fuentes, Jan Jose Esparragosa-Moreno, and Ismael Zambada-Garcia. They cooperate in moving cocaine to major U.S. cities.
3. **Armando Valencia Organization.** Armando Valencia-Cornelio is a key figure in the interrelationship between major Mexican and Colombian drug trafficking organizations. The organization is based in Guadalajara, Jalisco, and the state of Michoacan. The Valencia Organization was receiving 20 tons of cocaine on a monthly basis. These shipments were transported to the west coast of Mexico from the north coast of Colombia via maritime vessel, and subsequently moved to the U.S. On August 15, 2003, Armando Valencia-Cornelio and seven of his associates were arrested in Mexico at a restaurant near Guadalajara. They are facing charges in both Mexico and Miami.
4. **Miguel Caro-Quintero Organization.** The head of this drug trafficking organization was arrested in 1985 for his involvement in the murder of DEA Special Agent Enrique Camarena. Miguel Angel Caro-Quintero took the leadership of the organization until his arrest in December 2001. His brothers, Jorge and Genaro Caro-Quintero, and sister, Maria del Carmen Caro-Quintero, assumed control.
5. **Osiel Cardenas-Guillen Organization.** Osiel Cardenas-Guillen was a major marijuana and cocaine trafficker of the Gulf cartel. He was arrested on March 14, 2003. His former boss, Juan Garcia-Abrego, is currently incarcerated. Cardenas-Guillen is responsible for the attempted assault and abduction of DEA and FBI agents in Matamoros, Tamaulipas. Despite his incarceration, his organization remains active in drug trafficking.

Several major drug traffickers were arrested in 2002 and 2003. Mexican authorities have arrested Arturo Guzman-Loera, the brother of Joaquin Guzman-Loera (a.k.a. El Chapo) in January 2002. In March 2002, Benjamin Arellano-Felix was arrested in Puebla, Mexico. Miguel Herrera-Barraza (a.k.a. El Tarzan) was also arrested in March 2002. In

May 2002, the Mexican military apprehended Jesus Albino Quintero-Meraz, a top lieutenant of the Gulf cartel.

Bulk currency shipments continue to be the most prevalent method to move trafficking proceeds to Mexico. U.S. currency is concealed and transported by courier or cargo, either overland or by air. The money usually travels in the same vehicle or airplane that originally transported the drugs. Another common method of money laundering is drug proceeds being sent to Mexico through U.S.-based money service businesses. Money transmitters have operated with little or no controls. On August 18, 1999, the Financial Crimes Enforcement Network (FinCen) published regulations requiring money service businesses to comply with currency transaction reporting under the Bank Secrecy Act. So far, this has not deterred money transmitters from laundering drug money. It has, however, helped law enforcement to identify the money launderers.

### **12.3.10 Irish Organized Crime**

The Irish syndicate lost much of its territory and influence to Sicilian groups during Prohibition. However, it is still active in New York and Philadelphia by accommodation with La Cosa Nostra.

Irish organized crime is in the hands of three groups. Jimmy Bolger, a reputed killer, bank robber, and drug trafficker, controls one. The second is the McLaughlin gang. The third is headed by Howard Winter, who is involved in drug trafficking, hijacking, loan-sharking, and contract murder on behalf of the Angiulo branch of the Patriarca LCN family in New England.

The three gangs have divided Boston into territories. The Winter gang controls the docks and Local 25 of the International Brotherhood of Teamsters. The Irish share their income with the Angiulo group in North Boston.

In New York, the Irish gang is known as the Westies. It is led by James Coonan. Like Boston, the New York gang is closely connected with the LCN interests. Its overall impact on New York is insignificant, but its influence is considerable in the entertainment industry.

### **12.3.11 Russian Organized Crime**

There have been three waves of Russian emigration to the U.S. It has been speculated that the Soviet Union attempted to empty its prisons and rid its undesirables from 1971 to 1980, as Castro did in 1980.

The first indication of Russian organized crime is when a gang from the Odessa region began to perpetrate a con game against other Russians living throughout the U.S. The group became known as the Potato Bag Gang because victims who believed they had bought a sack of gold coins actually received only a bag of potatoes.

Russian crime figures have been operating along both the East and West Coasts of the U.S., as well as in some cities — Cleveland, Chicago, New Orleans, and St. Louis. They are involved in extortion, prostitution, insurance and medical fraud, auto theft, counterfeiting, credit card forgery, narcotics trafficking, fuel tax fraud, money laundering, and murder. On April 21, 1994, CIA Director James Woolsey told the Senate, “Organized crime is so rampant in Russia that it threatens Boris Yeltsin’s presidency and raises concern that syndicates will obtain and smuggle Russian nuclear weapons to terrorists or foreign agents.” The former attorney general, Janet Reno, named Russian organized crime groups in the U.S. as a priority target for the U.S. Department of Justice. The Brighton Beach area of

New York City became the hub for Russian organized crime in this country starting in the mid-1970s. The Russian criminals developed a working relationship with the LCN that allowed them to establish fuel tax fraud schemes in certain areas of New York. The LCN forced the Russian criminals to pay a large portion of their proceeds as a tax to operate. Organized crime groups in Russia are not nearly as structured as those in the U.S. A crime boss, called a pakhan, controls four criminal cells through an intermediary called a brigadier. The boss has two spies that watch over the action of the brigadier to ensure loyalty. At the bottom are criminal cells. These criminal cells specialize in various types of criminal activity, such as drugs, prostitution, and enforcement. This structure allows the leadership at the top to be insulated from the street operators. Street operators are not privy to the identity of the leadership. Strategy and planning are done at the top in order to minimize the risk of detection.

There is a traditional code of conduct within this style of organized crime in Russia, called Vory v Zakone, or thieves in law. In this society, the thieves in law live and obey the Vorovskoy Zakone, or thieves' code. The members are bound by 18 codes, and if they are broken, the transgression is punishable by death.

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## The Thieves' Code

A thief is bound by the Code to:

1. Forsake his relatives, mother, father, brothers and sisters.
  2. Not have a family of his own, no wife, no children; this does not preclude him from having a lover.
  3. Never, under any circumstances, work, no matter how much difficulty this brings.
  4. Help other thieves.
  5. Keep secret information about the whereabouts of accomplices.
  6. In unavoidable situations to take the blame for someone else's crime; this buys the other person time of freedom.
  7. Demand a convocation of inquiry for the purpose of resolving disputes in the event of a conflict between oneself and other thieves or between thieves.
  8. If necessary, participate in such inquiries.
  9. Carry out the punishment of the offending thief as decided by the convocation.
  10. Not resist carrying out the decision of punishing the offending thief who is found guilty, with punishment determined by the convocation.
  11. Have good command of the thieves' jargon, "Fehnay."
  12. Not gamble without being able to cover losses.
  13. Teach the trade to young beginners.
  14. Have, if possible, informants from the rank and file of thieves.
  15. Not lose your reasoning ability when using alcohol.
  16. Have nothing to do with the authorities, not participate in public activities, nor join any community organizations.
  17. Not take weapons from the hands of authorities; not serve in the military.
  18. Make good on promises given to other thieves.
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Intelligence indicates that most Russian organized crime groups are loosely organized and do not have elaborate levels of structure. They operate primarily as networks. Russian organized crime groups in the U.S. communicate and operate with their counterparts in Russia. In 1992, the Russian crime lords sent Vyacheslav Kirillovich Ivankov to the U.S. for the purpose of bringing them into the fold. Ivankov arrived in New York City on March 8, 1992. In a very short time, he expanded operations and made contacts with other Russian thieves. Ivankov paid \$15,000 to have an aging singer marry him so he could get a green card. They got a divorce in the Dominican Republic after he got his green card. In 1995, Roustam Sadykov, a Russian banker, asked Ivankov to collect money from Summit International. Ivankov and two of his henchmen kidnapped the two bankers, Alexander Volkov and Vladimir Voloshin. They were made to sign a note for \$3.5 million. Unknown to Ivankov, the FBI had wired the two bankers. On June 8, 1995, Ivankov was arrested. He was later tried and sentenced to the Manhattan Correctional Center. While there, he was found with heroin in his cell and later transferred to Allenwood Federal Penitentiary.

On the FBI's Most Wanted list, a Semion Mogilevich is wanted for a fraud scheme to defraud investors in YBM Magnex International, Inc., a public company incorporated in Canada. YBM Magnex is based in Newtown, PA. Investors lost more than \$150 million through a scheme of inflating stock values by preparing bogus financial books and records, lying to Securities and Exchange Commission officials, and offering bribes to accountants. A federal indictment was issued on April 24, 2003, in the Eastern District of Philadelphia. Mogilevich and two accomplices, Igor L'Vovich Fisherman and Anatoli Tsoura, are charged with 45 counts of racketeering, securities fraud, wire fraud, mail fraud, and money laundering. Mogilevich is a 52-year-old Ukrainian. He holds an economic degree from the University of Lvov and is known as Brainy Don. He has strong leadership qualities, acute financial skills, and talented and highly educated associates. His use of technology has made him impervious to prosecution. It is believed that Mogilevich paid off a Russian judge to secure Vyacheslav Ivankov's early release from a Siberian prison.

It has also been discovered that the Russian Mafia is involved in drugs in South Florida. Ludwig Fainberg, known as Tarzan, ran Porky's Strip Club in Hialeah, FL. Tarzan was born in Odessa, Russia, in 1958. In 1980, Tarzan fled Moscow to Brighton Beach, NY. In 1990, he moved to Florida after some of his associates were murdered. He opened Porky's with the help of Willaim Seidle, who was connected to the LCN. Later, he linked up with Colombian drug cartels through Juan Almeida and Fernando Birbragher. Birbragher had close ties to the Cali drug cartel and is a friend of Pablo Escobar. Tarzan brokered the sale of six MI8 Russian helicopters in 1993. In 1996, Tarzan made a deal to acquire a Piranha class submarine from the Russian Navy for \$5.5 million. The deal did not go through since Tarzan was arrested by the DEA on January 21, 1997. Tarzan pleaded guilty to racketeering charges, including conspiracy to sell heroin, cocaine, and the submarine, and other charges. On October 14, 1999, Tarzan was deported to Israel with only \$1,500 in his pocket. He served only 33 months in prison.

The Russian mobsters are described as intelligent, professional criminals. Many have master's and doctorate degrees. Extortion appeared to be the most frequent crime in the Russian communities during the 1970s, 1980s, and early 1990s. The Russian immigrant community is also a target of insurance fraud and con games. There are reports that Russian gangs in New York are linked to the Genovese family. Police have found that the Russian gangs have to pay tax to the Genovese family to operate fuel scams. Police suspect that

Evsei Agron was murdered by LCN because of a territorial conflict. Russian communities in this country are closed and suspicious of police.

### 12.3.12 Canadian Organized Crime

There are three major factions in Canadian organized crime, which are active around the border region. In addition, members of Canadian crime groups have begun to concentrate in South Florida in an apparent expansion of both the scope and base of their criminal enterprises.

The Vincent Cotroni crime family was identified during the 1960s and is an affiliate of the Bonanno LCN family in New York. Two Cotroni members from Montreal were convicted on drug conspiracy involving associates of Carmine Galante, a Bonanno capo. Today, the Cotroni group is headed by Santos “Frank” Cotroni and is engaged in drug trafficking.

Nine brothers control the French Canadian Dubois gang in Quebec Province. Four brothers are currently in prison. In 1985, Jean Paul Dubois headed the gang. Its main activity is drug trafficking.

Johnny McGuire, a one-time labor racketeer, has been called “the Canadian Jimmy Hoffa.” Today the crime group, headed by McGuire, works its own rackets and cooperates with other groups in smuggling drugs, guns, and stolen cars into Canada.

In 1963, Pasquale Cuntrera, boss of the Siculiana family, left Italy. He went to Caracas, Venezuela, where in 1964 he established, with the approval of the Cupola, the base of the Siculiana family. The most-known members of the Siculiana family living in Canada are Nicolo Rizzuto, Vito Rizzuto, Paolo Renda, Giuseppe Lopresti, and Agostino Cuntrera. The Rizzutos have very close ties with the Gambino, Bonanno, and DeCavalcante families in the U.S. The year 1973 marked the beginning of the feud for control of criminal activities in Canada between the Cotroni and Rizzuto families. Nicolo Rizzuto achieved his goal by killing Paolo Violi, underboss of the Cotroni family, and Francesco and Rocco Violi, Paolo’s brothers. In 1984, Nicolo Rizzuto took control of all criminal activities in Canada after the death of Vincent Cotroni. In 1988, Nicolo Rizzuto was convicted in Caracas, Venezuela, for cocaine trafficking. His son, Vito Rizzuto, became the boss of the family. The Rizzuto crime family controls most of the gambling operations in Canada. Gambling consists of bookmaking, video poker machines, and casino operations. The Rizzuto crime family is also involved in narcotics, extortion, corruption, and money laundering.

Canadian organized crime groups have considerable presence in Florida, finding their customers and victims among both Floridians and the nearly 1 million Canadians who visit Florida. They engage in drug trafficking, loan-sharking, bookmaking, and smuggling stolen automobiles.

In Florida, Canadian gangs are close to points of supply for cocaine. The trade in handguns smuggled to Canada is also lucrative, since weapons are easily available in Florida. Canadian crime groups have heavily invested in Florida business and real estate, particularly beachfront property. In some cases, they obtained the property after intimidating legitimate buyers. Since 1982, there have been a number of bombings involving eight pizza parlors in South Florida. Two Gambino family members who had been trying to open pizza restaurants in what apparently was Canadian-claimed territory were murdered and found dead in the trunk of their car in Dade County.



### 12.3.13 Jamaican Posses

The Jamaican posses are a growing group of bold and dangerous individuals who traffic in large quantities of firearms and narcotics. There are about 40 posses operating in the U.S., Great Britain, Canada, and the Caribbean, with an estimated 10,000 members. These illegal activities are increasing along with the propensity for violence. The posses are attributed to be responsible for over 1,000 homicides nationwide. About 1976, two large violent groups emerged on the island of Jamaica: the Reatown Boys and the Dunkirk Boys. The Reatown Boys consisted of people from Reatown, Jamaica, most of whom became known as the Untouchables. They were loyal to the People's National Party. They later became known as the Shower Posse, the largest posse. The Dunkirk Boys became known as the Spangler Posse, the second largest posse. They were aligned with the Jamaica Labor Party. These two posses distribute drugs on a wholesale and street level in many large cities in the U.S. Most of the Jamaican posses believe in a doctrine called Rastafarian. The original thrust was for improvement of conditions in Jamaica, and eventual migration of Black people back to Africa, specifically Ethiopia. The most universal beliefs are:

1. Rastafarian is the living God.
2. Ethiopia is the Black man's home.
3. Repatriation is the way of redemption for Black men.
4. The ways of the white man are evil.

Other doctrines, which are not universally adhered to, are:

1. Eating pork is forbidden.
2. The "herb" marijuana or ganja is a gift of God, who enjoined us to smoke it.
3. Beards and long hair are enjoined on men; it is a sin to shave or cut the hair.
4. Alcohol is forbidden, together with gambling.

When they recognize Emperor Selassie as God, they make a vow or pledge accepting the laws and decrees of conformance. Not all Rastafarians are criminals and not all Jamaicans are Rastafarians.

The Jamaican posses have a proclivity for violence seldom seen in other organized crime groups. They have little regard for public safety or human life. The posses violence can be directed at members of their own groups, rival groups, or others who may interfere with their drug territories. Age and sex present no barrier to their acts of violence. They have killed women, children, friends, and relatives. The Jamaican posse members have the following general traits:

1. They are usually well armed with high-powered weapons.
2. They will confront and kill police.
3. They use extensive surveillance methods.
4. They have disregard for innocent bystanders.
5. They use extensive aliases and false identification.
6. They use females to transport narcotics and weapons and to make weapon purchases.

In recent years, the Jamaican posses have begun establishing working relationships with other organized crime groups. LCN is working with the Jamaican posses, along with the Colombian cartels. Posse members have been known to steal credentials of police officers, federal agents, military officers, and intelligence officers. They have developed their own slang based on the existing elements of the English language. The Rastafarian language comes with a whole new vocabulary of *I* words, which express their individualism. The word *myself* is *I self*, and *ourselves* is *I n I self*. This new language is used to:

1. Prepare cover stories
2. Identify true believers
3. Plan criminal acts
4. Appear to not know English

Jamaicans are highly mobile with tremendous access to false identification. Weapons are a mark of manhood. High-quality weapons are a status symbol. In some posses, assaults or murders are used as membership requirements.

Jamaicans lack many of the sophisticated money laundering methods. Most posses prefer to avoid direct use of traditional financial institutions. They smuggle most of their proceeds out of the U.S. They use wire transfer companies by structuring their transactions. Higglers are street merchants in Jamaica. They travel to the U.S. and purchase merchandise for resale in Jamaica using posse funds. The goods are sold in Jamaica and the money is given to the posses. The Jamaicans use friends, relatives, and other “straw” purchasers to hide the true ownership of property. They like to use women’s names in leasing cars and apartments and obtaining other items. They have in recent years acquired small businesses, mostly cash sales operations, i.e., restaurants, grocery stores, nightclubs, record stores, boutiques, and garages.

#### **12.3.14 Israeli Mafia**

During the 1980s, the Israeli Mafia was discovered operating in the U.S. They are involved primarily in narcotics trafficking. They use business fronts to launder their profits. Most Israeli Mafia members were born in a Middle East country and emigrated to Israel, where vast cultural and language difficulties were experienced. Most of the criminal elements were born in an Arab country, within a poor economic situation. Many were not able to assimilate into the Israeli culture. The Israeli National Police arrested and incarcerated many for criminal activity. Many of the Israelis left Israel for other countries in order to pursue a lifestyle of criminality. It should be noted that if the criminals remained in Israel, their prospect for financial success would be limited since Israel and its populace are not financially prosperous. In the U.S., the Israeli Mafia are loose-knit. They have ties to the heroin trade in the Middle East and Southeast Asia, and to the cocaine trade in Colombia, Peru, Brazil, and Mexico. Besides drug trafficking, the Israeli Mafia are involved in other criminal activities, such as extortion, fencing stolen property, and various kinds of fraud. They use the following methods of disguise:

1. They use one another's addresses on official documents, particularly driver's licenses and vehicle registrations. The true resident would deny any knowledge of anyone listed on any document.
2. The inclusion or omission of the Hebrew word *Ben* in their last name. This word means "son of."
3. The Hebrew alphabet is phonetic and there is usually only one way of spelling a word or name. When translating a Hebrew name into the Roman alphabet, mistakes, whether intentional or unintentional, can occur in the spelling. The phonetic word *Levy* can be translated into Levey, Levi, Levie, Leve, Leive, etc. These variations of spelling can provide numerous legitimate documents that can be used for identification purposes.

In the past, Israeli Mafia members maintained a low profile and a pretentious lifestyle. They met in small social clubs and drove old vehicles. Recently, members are driving luxury vehicles, are smartly attired, wear expensive jewelry, and frequent luxury cabarets.

### 12.3.15 Gypsies/Travelers

The gypsies are people from Eastern Europe who have distinct coloring and body structure. The travelers are people from Ireland and the British Isles who have Caucasian coloring and cast. Both groups are involved in the same type of criminal activity of home invasions, shoplifting, store diversions, fortune telling, and jewelry store operations. The gypsies are dark skinned, have black or brown eyes and black hair, and are short and stocky. They like to wear colorful clothing. The gypsies are small in number in the U.S. and seem to remain on the lower economic scale. The travelers, on the other hand, have become much more prosperous. They are scattered throughout the U.S., but the larger clans are concentrated in or around North Augusta and Defilade, SC. Other clans are located near Memphis, TN, and Ft. Worth, TX. Their numbers are estimated to be around 6,000 individuals. The travelers live in a closed society. They do not socialize with nontravelers and discourage marriage outside the clan. Travelers get together about four times a year. At all other times, they are traveling and engaging in fraud and criminal activities. Men are the primary workers and heads of their families. The travelers prefer to operate in rural areas. The European gypsies prefer to work in urban areas because they can blend in with many cultural groups, targets of opportunity are more available, and they get assistance from other gypsy groups. The gypsies and travelers like to seek the elderly because:

1. They may live alone.
2. They are easily intimidated.
3. They make poor witnesses due to failing eyesight and memory capability.
4. They keep large sums of cash in their homes.
5. They cannot physically make home repairs or improvements.

Both the travelers and the gypsies are mostly involved in consumer fraud. Their primary operations center on:

1. **Painting.** The basic element here is giving an exaggerated estimate for the job and using cheap grades of paint, poor quality due to thinning, and poor workmanship.

2. **Roof repair.** They use poor materials and workmanship. In addition, they will drive their victim to the bank to get cash for a discount.
3. **Home repairs/service.** They will pose as termite or building inspectors to advise people of bad conditions. They offer to do the repairs for an exaggerated fee; the quality of the finished work, if done at all, is poor. This is also used to get into people's homes for the purpose of canvassing and stealing valuables and money.
4. **Auto body repairs.** Travelers look for dented automobiles. When found, they offer to repair them for a low fee. After repairs are done, they will attempt to inflate the price.
5. **Selling tools.** The travelers like to sell cheap tools at inflated prices at flea markets, highway intersections, and even door to door.
6. **Social Security/health scam.** Here, two travelers pose as Social Security or health department workers. They offer to give a free physical to the victim. While one traveler is keeping the victim's attention, the other is stealing money and valuables from the house.
7. **Recreational vehicle sales.** The travelers purchase poorly constructed RVs and sell them at two to three times their cost. These RVs are not inspected or approved by many states that have established standards of construction and safety requirements.

The principal characteristics of the travelers are:

1. **Workers.** The men do most of the work.
2. **Vehicles used.** The travelers use late-model pickup trucks. There are no business names or advertising shown on the trucks.
3. **Housing on the road.** The travelers usually stay in family-oriented motels, campgrounds, and trailer parks.
4. **Group size.** They usually travel in groups of three to five vehicles with 10 to 15 people.
5. **Travel.** Travelers spend 40 to 70% of their time engaged in nomadic activity.
6. **Identification.** Travelers will have many sets of identification from different states. Identification should be checked with vehicle registration.

### 12.3.16 Haitians

The Haitians are not highly organized, they operate in gang fashion, and, for the most part, they are not highly educated. Many are illegal aliens in the U.S. Even though they are not highly educated and are loosely organized, they are becoming a very effective organized crime group. In South Florida and elsewhere, they are successful in robberies, home invasions, and thefts. Since Haiti is a poor country, criminal groups have specialized in stealing bicycles, mopeds, small motorcycles, and economy automobiles and shipping them back to Haiti for resale. In the late 1980s, U.S. Customs boarded a ship leaving Miami with the destination of Port-au-Prince. On the ship, there were 20,000 bicycles. They found that all of the bicycles were stolen. For the Haitian gang, these bicycles were pure profit. Their intent was to ship the stolen bicycles to Haiti, where they would be sold. The disturbing aspect of the Haitians is that they are increasing their sophistication. This is because of their association with the Jamaican posses and other criminal organizations. The Haitians

are mostly Negroes and speak Creole. Since most cannot speak English very well, they are limited in what they can do.

### 12.3.17 Nigerians

The Nigerian criminal elements operate out of three clans. Two clans are Christians, while the other is Muslim. The Nigerians are highly educated. Many have master's and doctor's degrees. Nigeria was a British Crown colony until 1960, when it obtained its independence. Nigerians speak English with a British accent. This makes it easier for them to obtain employment and assimilate into American society. The Nigerians are principally involved in drug trafficking and various fraud schemes. They have cost the credit card companies millions of dollars in losses. They apply to credit card companies using people's names with good credit standing. The cards are sent to an address different from that of the true person. They use the card to the maximum credit limit. The goods are then sent to Nigeria for resale. The address where the card is sent is only rented for a short time, usually 3 to 5 months. Then the Nigerians move to another rented dwelling. They use false identification or other people's identification, which was obtained in business establishments that require identification or the use of credit cards. Sometimes, they read local newspapers and use prominent people's names. Nigerians are involved in many fraud schemes. They get low-income housing, even though they do not qualify. They are involved in food stamp fraud and other government programs. Nigerians are also involved in narcotics trafficking, principally heroin, which is imported from Africa and the Middle East. They can be violent, but generally are not, except in their drug trafficking operations. One unique characteristic of Nigerians is that they will deny any wrongdoing even when caught red-handed. They never admit to any crime.

### 12.3.18 Palestinians

The Palestinians are involved in fraud and weapons smuggling. They like to use convenience stores for fronts. They are involved in cashing checks for high fees, and paying cash for food stamps at half the face value. Most of their business establishments are located in economically depressed areas. Profits are used to obtain various kinds of weapons for shipment to the Middle East. The Palestinians sponsor other Palestinians into this country. The new arrivals are set up in a convenience store. They repay their sponsor from their profits. They keep two sets of books, one for the sponsor, which is kept correctly, and the other for government-reporting purposes. The second set of books does not show all their income. It does not show the payments to the sponsor or the skimmed receipts. Weapons are purchased or stolen and shipped to the Middle East. There, they are sold to various terrorist groups. They will cooperate with the Israeli Mafia, if profits are available.

## 12.4 Organized Crime Patterns

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Organized crime groups have a pattern of four stages of development:

1. **Tactical crimes.** Most criminals start their career at this stage. It is labeled "tactical" because local law enforcement will have to use tactical methods of detection. The most common crimes in this category are:

- a. Arson
  - b. Assault
  - c. Bribery
  - d. Burglary
  - e. Corruption
  - f. Extortion
  - g. Hijacking
  - h. Murder
  - i. Robbery
2. **Illegal business activities.** When criminal groups become more organized, with a leadership structure, they move into more illegal enterprises. The most common include:
- a. Counterfeiting
  - b. Fraud
  - c. Gambling
  - d. Illegal alcohol
  - e. Loan-sharking
  - f. Narcotics
  - g. Prostitution
  - h. Protection rackets
  - i. Smuggling
  - j. Stolen property
3. **Legitimate business.** When criminal groups have developed a good organizational structure, they turn to legitimate business to disguise their profits and to appear respectable in the community. At the same time, they must obtain a business that lends itself to hiding their illegal profits without attracting attention from law enforcement and tax authorities. The most common businesses used by organized criminal groups are:
- a. Auto agencies
  - b. Factoring
  - c. Food products
  - d. Garment manufacturing
  - e. Juke boxes and video machines
  - f. Liquor distributors and sales
  - g. Nightclubs and bars
  - h. Trade unions and associations
  - i. Trucking
  - j. Vending machines
  - k. Waste collections
4. **Big business.** When retaining lawyers and accountants sophisticates criminal groups, they get involved in larger businesses. They do this mostly to obtain respectability in the community and to launder their illegal gains. The most common businesses are:
- a. Banking
  - b. Construction
  - c. Credit cards
  - d. Entertainment

- e. Hotels and motels
- f. Insurance
- g. Labor
- h. Mortgages
- i. Real estate
- j. Securities

The fraud examiner will be involved in the last three stages. Each stage will require different investigative and audit techniques. Stage 2 requires more investigative techniques than audit techniques, while stage 4 requires many more audit techniques than investigative techniques. The more complex the enterprise, the more time that is required to uncover the fraud.

## 12.5 Summary

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There are 18 criminal organizations based on race or ethnicity. Some groups are very sophisticated, with a structured hierarchy, while others operate in gangs with a single leader. Criminal organizations operate primarily in large metropolitan areas. They are rarely found in rural areas. Criminals usually do not have any outward signs of being a criminal. However, in some criminal organizations, the membership can be easily determined by how they dress, body tattoos, how they speak, or their demeanor. The financial investigator should become familiar with criminal organizations. He should know their methods of operation and their organizational structures. A case cannot be made without knowing the organization's structure and how the funds flow through it. Money laundering and racketeering are the most common charges for criminal organizations. For criminal organizations involved in drug trafficking, continuing criminal enterprise charges are most common, along with money laundering.



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## 13.1 Definition

A forensic accountant will sooner or later have to prepare for a trial and testify in a court of law. This is the basic function of a forensic accountant — to present accounting data that is admissible in a court of law. The purpose of this book is to prepare the accountant to do so. Forensic means anything that is admissible in a court of law or open to public debate.

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## 13.2 Trials and Hearings

The forensic accountant will have to testify in some kind of legal proceeding, whether for the prosecution or defense in a criminal case, or the plaintiff or respondent in a civil case. The complexity of any case will depend on the issues raised. Some cases will only require a small amount of time to study and testify about, while others will require many hours of study and testifying. In any case, the forensic accountant's testimony will provide the basis for the judge's rulings. The forensic accountant will normally be called to testify in the following types of legal proceedings:

**Criminal trials.** The forensic accountant will normally testify about the defendant's net worth and expenditures, whether for the prosecution or defense. This will require a lot of time to study and testify in court. Other cases involve the tracing of funds and assets.

**Civil trials.** The forensic accountant will normally testify about the plaintiff's or respondent's financial status. Most cases usually involve income tax litigation or divorce asset division and/or ability to make alimony and/or child support payments. The time required will depend upon the complexity of the case.

**Hearings.** The forensic accountant will testify before a judge. No jury will be present. In criminal cases, the testimony will be aimed at the defendant's financial position or financial affairs. A bond hearing is a common example of this kind of hearing.



In civil cases, the forensic accountant will testify about the plaintiff's or respondent's financial condition or ability to pay a claim.

**Deposition.** The forensic accountant will give testimony about some issue that involves litigation between two parties. There is no judge or jury present.

**Sworn statement.** In this case, the forensic accountant will give a sworn statement about a particular issue. There is no judge or jury present. This is a one-sided situation. The sworn statement is given in response to questions and answers asked by an attorney for his client or the government.

### 13.3 Preparing

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As soon as you find out that you will be testifying, you should begin preparing for the witness chair. Regardless of your role, you should take the following steps:

1. First, discuss with the attorney what is expected, how your testimony is to be used, and when you will be expected to testify.
2. Review all available documents pertaining to the issues being litigated.
3. Discuss your testimony with the attorney and what line of questioning will be used to develop the case, and have a general idea of how you will respond to those questions.
4. Consider what the opposing counsel's approach will be and the areas it will most likely probe during cross-examination.

### 13.4 Testimony

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#### 13.4.1 Expert/Summary Witness

An expert witness is a person skilled in some art, science, profession, or business or who has experience or knowledge in relation to matters that are not commonly known to the ordinary person. (See Federal Rules of Evidence, Rule 702, 28 USCA [U.S. Code Annotated.]) The ordinary witness testifies to facts, that is, what one has seen, heard, or otherwise observed. The expert witness expresses an opinion or answers hypothetical questions based on facts presumably in the record. It should be kept in mind that the expert witness testimony is entirely within the province of the jury to determine the weight given to such opinions. The jurors are not bound by the opinion of experts.

#### 13.4.2 Duties and Responsibilities

The forensic accountant has various responsibilities and duties during a judicial proceeding. They are as follows:

1. In criminal cases, review the prosecution memorandum.
2. In criminal cases, review the indictment (if the case was presented to a grand jury) or the information (if the charges were filed by the federal or state prosecutor), which sets forth the specific allegations of the criminal act.

3. Review the anticipated evidence available to prove or disprove the indictment or information in criminal cases, or support or deny the plaintiff's or respondent's position in a civil case.
4. Check the mathematical accuracy of the accounting data that are to be presented in court, whether criminal or civil.
5. Advise the attorney of the potential accounting or technical problems.
6. Determine the clearest manner to present testimony, in terms that the jury of laypersons will understand.
7. Prepare tentative summary computations, based on the evidence that is expected to be admitted.
8. Supply to the attorney that you are assisting a written statement of your qualifications as a forensic accountant or a current resume.
9. Testify only to those matters that are admitted by the court into evidence, as either testimony or documents, or by stipulation.
10. Take notes regarding the evidence that is admitted and prepare a list of documentary exhibits of both sides, whether a criminal or civil case.
11. Alert the attorney regarding any evidence that has been overlooked. It is important that all evidence necessary to support your testimony has been admitted.
12. Allow enough time to check your computations and review witness testimony. You should be sure to make copies of those computations for the jury, court, and counsel. This helps the jury to understand your testimony. Some judges will not allow jury members to have copies of exhibits, while others will.

### 13.4.3 The Do's

To be a good witness, there are things that you should do or observe:

1. Speak up so that the jury, judge, stenographer, opposing counsel, and all other parties in the case can hear you.
2. Define technical terms and put them into simple language so the jury, judge, and counsel can understand them. Express yourself well, using simple technical language that the jury, judge, and attorneys can understand.
3. In testifying, refer to the exhibit number or some other identification. When indicating or pointing to an object in the exhibit, you should describe what you are referring to so that the court stenographer can make an accurate and complete record of your testimony.
4. Take enough time in answering questions to gather your thoughts and give an accurate and brief answer. If you are asked to give an opinion and feel that you do not have enough facts or enough time to form an intelligent expert opinion, so inform the court. The jury is impressed with such frankness on the part of the witness.
5. Always have adequate notes available so that you can testify regarding all of the details.
6. Walk to the witness stand with even steps.
7. When taking the oath, hold your right hand high with fingers straight and look at the officer administering the oath. When the officer finishes the oath, you should answer "I do" in a loud voice so that all in the courtroom can hear. Do not act timid.

8. Think before you speak.
9. When one of the lawyers calls “Objection” or the court interrupts, stop your answer immediately and wait until the court gives its ruling.
10. Be fair and frank.
11. If you make a mistake, or a slight contradiction, admit it and correct it. Do not tie yourself up in knots trying to cover up some slip of speech or memory.
12. Keep your temper. Be firm, but flexible.
13. If you cannot answer “yes” or “no,” say so.
14. If you do not know or cannot remember, say so.
15. Avoid mannerisms of speech.
16. “Do you want this jury to understand ...?” Listen closely to this question. If you do not want the jury to understand it that way, make clear what you want them to understand.
17. Never try to be a “smart” witness.
18. Be brief. Just answer the question and stop.
19. During the recess, do not carry on any conversation with other witnesses or parties to the controversy. You should stand aloof from everyone except the attorney who retains you to testify.
20. Wait until the entire question is asked before answering.
21. On cross-examination, do not look at your attorney.
22. Keep your hands away from your mouth or face.
23. Be serious and business-like during recesses and on the witness stand.
24. Stay away from opposing counsel, the defendant or plaintiff, and his or her witnesses.
25. Be available and answer promptly when called to testify.

#### 13.4.4 The Don'ts

The following items are things that you should *not* do:

1. Don't discuss the case in the corridors.
2. Don't chew gum.
3. Don't memorize any of your testimony.
4. Don't nod or shake your head to indicate “yes” or “no.”
5. Don't make any public display of elation or disappointment over the outcome of the case after the verdict has been rendered.
6. Don't volunteer any information.
7. Don't show any emotion about proceedings, such as disbelief or astonishment.
8. Don't allow yourself to get caught in the trap of the defense counsel asking you to answer a question by either “yes” or “no.” Some questions cannot be answered this way, and you should so state to the court and jury and ask for permission to explain your answer.
9. Don't get caught by snares such as “Did you ever discuss this with anyone?” Of course you did, and if asked, name the people, the lawyers, and the parties to the suit.
10. Avoid horseplay in corridors. Don't be noisy.

Cross-examination will be your most difficult time on the witness stand. Opposing counsel will attempt to confuse you, discredit you, and destroy the value of your testimony.

### **13.4.5 Trial Presentation**

In presenting financial information in a trial, whether civil or criminal, the following steps should be followed in order to get the maximum effect:

1. Before trial, set up net worth or other schedules with all items expected to go to trial listed. Do not list any references until the items have been admitted into evidence. This serves as a control to ensure that everything that must be entered is entered.
2. As a summary witness, before going on the stand, take a recess of 4 hours, more or less, to go over all items on the schedules to be presented.
3. In trial, try to get the attorney to present his witnesses in the following order:
  - a. Custodian of records
  - b. Case investigators
  - c. Likely source-of-income witnesses
  - d. Summary witness

This serves to help the summary witness in several ways. First, it gets all documentary evidence in first, whereby the summary witness can have time to double-check his computations and review the evidence. Second, it impresses the jury of the defendant's having been involved in illegal activities and the financial effect of these activities.

## **13.5 Summary**

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The basic rules for the fraud examiner and investigator are to truthfully testify in court. His or her demeanor should reflect professionalism. Fostering cooperation with the attorney can be greatly beneficial. Communication between the attorney and other fraud examiners or investigators can enlighten you, as well as those around you, on the case. The fraud examiner and investigators should expect to work long hours during the trial. Most of the work is done outside the courtroom, not in it. The fraud examiner should be very familiar with the case. If not, he or she should study the case files at least a week before the trial begins. The fraud examiner and investigator may not go to trial on the case for many months or years after they have worked the case. In those instances, the fraud examiner and investigator must refamiliarize themselves with the case.



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# Accounting and Audit Techniques

# 14



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## 14.1 General

The forensic accountant must identify what accounting techniques and audit programs to use and when to use them. The criminal elements will use whatever means to cover up their acts. Criminal organizations use teams of lawyers and accountants to legitimize their illegal income. Such use of professionals requires sophisticated accounting techniques to uncover their schemes. This, in turn, requires more time, funding, and personnel. Individuals can also develop fraudulent schemes of a high degree of sophistication. This chapter identifies the more common accounting techniques and audit programs that the forensic accountant can use to uncover the fraudulent schemes used by criminals.

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## 14.2 Net Worth and Expenditure Methods

In previous chapters, the net worth and expenditure methods have been discussed in detail as to how to prepare and present them in a court of law. The forensic accountant should also know when to use them. These methods are very powerful tools in both civil and criminal cases. They are most appropriate when the subject's lifestyle appears to be much higher than known or probable sources of income. An extreme example would be a person who lives in a \$100,000 house and drives an expensive automobile, but works at a fast food restaurant making income close to the minimum wage, or is not working at all. These methods are particularly applicable to organized crime figures, narcotics traffickers, and other racketeering activities. In these cases, most of the witnesses against the leaders are usually convicted criminals. The best defense is to attack the credibility of these witnesses. At times, the defense wins a not guilty verdict when there is not corroboration. The net worth and expenditure methods help corroborate witnesses' testimonies by showing the income witnesses paid the leaders and how the leaders disposed of the funds.

### 14.3 Tracing

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This accounting technique involves the flow of funds. It shows the flow of funds from bank to bank, entity to entity, person to person, or a combination of each. This technique can be used in organized crime cases or on individuals. Its primary purpose is to identify illegal funds and trace them to the beneficiary in criminal or civil cases. In civil cases, its purpose is to trace funds from a source to the end receiver. Table 14.1 illustrates a tracing schedule. It should be noted that the sources initially identified are greater than what the end beneficiary receives. The courts have ruled that the exact amount is not necessary to establish, but only that the end receiver received funds from an illegal source over an established period. This accounting technique is very useful in money laundering cases, regardless of the illegal activity. This tracing schedule uses the scenario problem in Section 7.3.

It should be noted that the Transshipment, Ltd., bank account was used to purchase real estate in the Bahamas; however, the offsetting (“In”) is not shown. This is because it did not go to another bank account.

Also, the transfer from the Transshipment, Ltd., bank account in Switzerland goes to the Doe Holdings bank account in Aruba. This example shows the subject making another step in transferring funds before they reach their final destination. Funds can go through many bank accounts and entities before reaching their final destination.

### 14.4 Check Spreads

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This is an accounting method that should be used when the subject uses checking accounts. In a forensic accounting situation, the use of check spreads is different from the normal accounting practices. The forensic accountant must have the following information to perform a check spread:

1. **Date.** The date of the check must be recorded. The date the check cleared the bank is not necessary. The main purpose is to determine the intent of the subject, which would be the date the subject wrote on the check.
2. **Payee.** The name of the payee must be shown. This identifies the person or entity that is supposed to receive the funds.
3. **Check number.** The check number identifies the instrument that is paying the payee. It is useful in that it can identify the specific payment made. It shows in numerical order the payments made to any individual or entity. It serves as a good reference to identify specific transactions.
4. **Amount.** This shows the amount of funds used or given to an individual or entity. This serves as evidence in showing the cost of a purchase, whether as an asset, expense, or reduction in a liability.
5. **Bank from.** The purpose of this is to show what bank account this expenditure was made from. The subject could have more than one bank account, and usually does. This identifies which bank account the subject is using. This can be the specific bank account number or a code that identifies the bank account, which is listed elsewhere.

**Table 14.1 John Doe's Tracing Schedule**

Date	Description	Bahamas Transshipment, Ltd.		Cayman Islands Transshipment, Ltd.		Barbados John Doe	
		In	Out	In	Out	In	Out
6/1/X2	Cash	\$2,000,000					
6/30/X2	Cash	1,000,000					
7/1/X2	Blue Lagoon Realty <sup>a</sup>		\$110,000				
10/1/X2	Cash	5,000,000					
3/1/X3	Cash	10,000,000					
3/31/X3	TRF Cayman Islands		\$2,000,000	2,000,000			
3/31/X3	TRF Barbados		2,000,000			\$2,000,000	
				Spain Transshipment, Ltd.		Switzerland Transshipment, Ltd.	
				In	Out	In	Out
3/31/X3	TRF Spain		1,000,000	1,000,000			
3/31/X3	TRF Switzerland		1,000,000			1,000,000	
12/10/X3	TRF Switzerland		3,000,000			3,000,000	
12/20/X3	TRF Switzerland to Aruba						\$2,000,000
				Aruba Doe Holding NV		Jamaica John Doe	
				In	Out	In	Out
3/31/X3	TRF Aruba		370,000	370,000			
4/04/X3	TRF Jamaica		1,000,000			1,000,000	
4/4/X3	TRF Aruba		100,000	100,000			
4/3/X3	Boat repair shop						100,000
4/10/X3	Montego Bay Hotel						20,000
4/10/X3	Gulf Oil						500
10/1/X3	Cash	8,000,000					
12/20/X3	TRF Switzerland			2,000,000			
				Panama			
				In	Out		
3/31/X3	TRF Panama		500,000	500,000			
12/1/X3	TRF Panama		3,500,000	3,500,000			
	Total	26,000,000	14,480,000				
	Balance	11,520,000					

<sup>a</sup>Bahamas residence.

- Bank to.** This should show the bank account where the check was deposited, in other words, the ultimate payee's bank account. This can show the specific bank account number or use a code that identifies the bank account. This field is mostly used for payments made to other bank accounts and entities that are controlled by the subject.
- First endorsement.** The first person or entity that endorses the check should be shown. It is possible and sometimes common that the person who the check is made payable to is not the person or entity who receives the check. The check could



be made payable to a John Smith, but the check goes into an account called ABC Corporation with John Smith's signature. Also, someone who is not John Smith could cash the check. Therefore, the person or entity that endorses the check can be very important.

8. **Second endorsement.** The payee or first person receiving the check may give it to a second person who will endorse the check. Attention should be focused upon the second endorsement. This may be a kickback or diversion of funds. The ultimate receiver of the funds should be fully identified regarding any relationships with the company or person providing the funds.
9. **Account.** The purpose of this field is to group similar transactions. It can be used to group transactions for a particular type of expenditure or for a particular purpose. Account means purpose. For trial presentation, the forensic account may use "Purpose" as the heading so the jury of laypeople can understand it.
10. **Note.** This field is used to show any memos or notes on the check. It also can be used to record any peculiar item on the check, such as different amounts between the figure amount and the written amount.
11. **First signatory.** This field should show the person who is the primary signatory on the check. This can be important in determining who has control over the bank account.
12. **Second signatory.** This field should show the second person who has cosignatory authority over the checking account. This person has some degree of control over the bank account.

If the investigator or analyst records this on a computer using a database, then various printouts can be produced. The above fields can sort the check spread. This will show patterns of activities. Check spreads also can offer more leads that will need to be further investigated. Additionally, they provide data that will be used for the net worth or expenditure schedules.

## 14.5 Deposit Spreads

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This is an accounting method that should be used when the subject uses checking accounts. The previous section deals with the disbursements from the checking account. This section deals with the receipts into the checking account. The use of deposit spreads is different from other normal accounting practices. The forensic accountant should have the following information in a deposit spread:

1. **Date.** The date of the deposit is recorded here. The date shows the time when the funds are received by the bank.
2. **Source.** The source shows from whom the funds were received. For cash deposits, the source would not be known unless the subject kept other records to show who paid the funds to the subject.
3. **Amount.** This shows the amount of funds received by the individual or entity. This amount should only show the deposited item and not the total of all the items in a deposit.

4. **Bank.** The purpose here is to show into what bank account the deposit was made. The subject could have more than one bank account, and usually does. This identifies into which bank account the subject made the deposit. This can be the specific bank account number or a code that identifies the bank account, which is listed elsewhere.
5. **Account.** The purpose of this field is to group similar transactions. It can be used to group transactions for a particular type of deposit or for a specific purpose. Account means purpose.
6. **Reference.** This field should list the number of the item deposited, usually the check number or draft being deposited.
7. **Number of items.** Many times deposits contain more than one deposited item. Each item in the deposit should be recorded separately. In order to connect all items in the deposit, this field will give the total items in the deposit. The date will be the same for each item in the deposit.
8. **Note.** This field should be used as a memo. The memo can record what was noted on the deposited item, or it can be used to record strange things about the item.

If the investigator or analyst uses a computer, then various printouts can be produced. The above fields can sort the deposit spread. Sorting deposited items by any of the above fields will disclose patterns and offer more leads that will need to be investigated. Deposit spreads provide data that will be used in the net worth or expenditure schedules.

## 14.6 Credit Card Spreads

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The credit card spreads should be used when the subject uses credit cards frequently. Credit cards are being used more and more these days. Some criminals use stolen credit cards to make purchases, which are later fenced. Other criminals use credit cards legally. In either case, credit card transactions should be analyzed. They are also important in that they show where a subject has been geographically. The fraud examiner should prepare a credit card spread using the following fields:

1. **Date.** The date should be the date of the transactions, not the date the credit card transactions were processed.
2. **Vendor.** The vendor is the company that sold the merchandise or provided the service to the credit card holder. It may be a valuable witness in trial, especially if the transaction is large.
3. **Credit card number.** This field should show the credit card account number or a code that will identify the specific credit card account on a separate listing.
4. **Amount.** This field shows the amount of the charge.
5. **Reference number.** The reference number should be the charge slip number. This is found on either the credit card statement or the charge slip.
6. **Signer.** This should record the person who actually signed the charge slip. There are occasions where more than one person can sign on a credit card. Sometimes there is no signature, but a statement stating "on file." This is common on mail orders. For criminal cases, the on-file slip should be obtained from the vendor to confirm that the subject signed for the purchase.

7. **Account.** The purpose of this field is to group similar transactions. It can be used to group transactions by either type or purpose.
8. **Note.** This field is used to record any unusual characteristics of the transactions.

Access to a computer can be very helpful. The above fields can sort the credit card data. This will show patterns in transactions and can offer leads that can be followed up. Credit card transactions are useful in showing the subject's whereabouts over time if he or she uses the credit cards a lot. The data from credit card transactions can be used on the net worth and expenditure schedules.

## 14.7 Gross Profit Analysis

An accounting method that is useful in cases of money laundering or skimming operations is gross profit analysis. The subject will acquire a legitimate business. Normally, this business will take in cash. In a skimming operation, the subject will withdraw money from the business. The funds do not reach the business bank account, but are diverted for personal use. In a money laundering operation, illegal funds are added to legitimate funds and put through the business bank account. The amount of funds that are either skimmed out or added in can be determined by finding out the cost of merchandise purchased and the normal sales price or markup. The following steps should be used to determine the amount of funds either skimmed out or laundered through the business:

1. The normal markups or sales prices should be determined. If there is more than one product with different markups, then each product markup will have to be determined.
2. Next determine the amount of merchandise purchased for each period under investigation. Product lines should be separated according to the different markup rates.
3. The markup rates for each product are applied to product costs. This will give the gross proceeds that should be generated from the sales of the products.
4. Once the gross sales have been determined for all products for the period, a comparison is made to the funds deposited into the business bank accounts. If the sales figures are higher than the bank deposits, then the difference indicates the amount of funds skimmed out of the business. If the sales figures are lower than the bank deposits, then this indicates the amount of funds laundered through the business.

A suggested gross profit schedule is presented in Figure 14.1.

	Product A	Product B	Product C
	Cost of sales	Cost of sales	Cost of sales
Divide:	C/S rate	C/S rate	C/S rate
Equals:	Gross sales	Gross sales	Gross sales
Less:	Deposits	Deposits	Deposits
Equals:	Skimmed/laundered income	Skimmed/laundered income	Skimmed/laundered income

**Figure 14.1** Gross profit analysis schedule.

The cost-of-sales rate is the percentage of cost of goods sold to the sales price for those goods. The gross profit method is used in bookmaking cases. It is called the commission or “Vig” method (explained in Section 14.12).

## 14.8 Witness List

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The use of either the net worth or expenditure method in criminal or civil cases will require many witnesses, most of whom will be records custodians. It is common to have anywhere from one to two hundred record custodians in an average case. Keeping track of these witnesses can be very time consuming. It is suggested that a computer database be used with the following fields:

1. **Name.** The full name of the individual.
2. **Firm.** The name of the company where the individual works as the record custodian. In case one individual is unable to testify, another person in the company can replace the initial individual.
3. **Street.** Street address and not a mailbox number.
4. **City.** The municipality of where the firm is located.
5. **State.** The state where the company is located.
6. **Home telephone.** This might be necessary if the records custodian is on vacation.
7. **Business telephone.** The telephone number of the company where the records custodian or the replacement, if needed, can be reached.
8. **Witness number.** The number as assigned by the attorney handling the case.
9. **Exhibit number.** The number assigned by the attorney handling the case.
10. **Exhibit description.** A brief description of what the documents are in the case.

The computer can sort these data by any of the fields mentioned. It normally takes a records custodian about 15 minutes to testify and introduce the documents. It is better for opposing counsels to stipulate rather than subpoena records custodians. If the records custodian has to be subpoenaed, then these data can be used not only to contact the witnesses, but also to help in scheduling them for the appropriate court date and time.

## 14.9 Bank Deposit Method

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Another indirect method of determining income, whether tax or Racketeer Influenced and Corrupt Organization (RICO), is called the bank deposit method. In tax cases, this is referred to as the bank deposit expenditure method, which more aptly applies. The IRS and state tax authorities have used this method for many years. It has not been used in RICO cases, primarily because it is not known by many fraud examiners or investigators. Also, it requires that the subject uses bank accounts to a great extent. This method is very useful for a subject who operates only one business and the income seems to come from only one source. The subject’s business is a cash type business, where receipts are received in cash.

### 14.9.1 Theory

Where a subject has income from an undisclosed source, the use of the bank deposit method is justified. Under the bank deposit method, the subject's gross receipts are determined by adding total bank deposits, business expenses paid in cash, capital items purchased in cash, personal expenses paid in cash, and cash accumulations not deposited in any bank account. For tax purposes, this is compared to the subject's gross income reported on the tax returns. For RICO purposes, this is compared to his identified income. The difference is the amount of unreported taxable income or illegal income. When this method is employed, each item of income and expense must be examined as to the source of funds and their subsequent use. This method is similar to the expenditure method, as discussed in Chapter 6.

### 14.9.2 Schedule

To illustrate this method in more detail, a schedule is presented in Figure 14.2.

This figure should be compared with the total identified income for RICO purposes, and the total gross income reported on the tax return for tax purposes. The difference will be either illegal income or unreported taxable income for the purpose used. The above schedule accounts for both the cash basis and the accrual basis.

## 14.10 Telephone

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The fraud examiner should be aware of telephone calls. Telephone calls will help identify personal contacts and associates of the subject. Also, they identify one of the subject's expenses. If the subject is a heavy telephone user, then this could be a major expenditure. This is particularly true with bookmakers who rely on the telephone for their business. Law enforcement will sometimes use a court-authorized wiretap or pen register. A pen register is a listing of telephone numbers that are either received or made by the subject. The fraud examiner will have to establish a database that will identify telephone contacts. This database should contain at least the following fields:

1. **Date.** This is the date the call is received or made.
2. **Caller.** This field should identify the person who is making the call. It could be the subject or another person.
3. **Receiver.** This field should identify the person who receives the call. This could be the subject or another person.
4. **Sender number.** This field should identify the telephone number of the person receiving the call. This could be the subject or another person.
5. **Receiver number.** This field should identify the telephone number of the person receiving the call. This could be the subject or another person.
6. **Time.** This field should show the time the call is either received or made.
7. **Length.** This field should show the length of the call in minutes, as a minimum.

Telephone calls usually will not identify assets or expenses, but they can identify leads to assets or expenses. Either the telephone company or a cross-reference guide can identify telephone subscribers. The subscribers can later be interviewed regarding their relation-

1. Total deposits:	
a. Business checking	\$ _____
b. Personal checking	_____
c. Savings	_____
Total deposits	_____
2. Plus cash expenditures:	
a. Business expenses	_____
b. Personal expenses	_____
c. Capital purchases	_____
Total cash expenditures	_____
3. Less total checks written:	
a. Bank balances 1/1/XX	_____
b. Total deposits for year	_____
Less: c. Bank balances 12/31/XX	( _____ )
Total cash expenditures	_____
TOTAL RECEIPTS	_____
4. Less nonincome items:	
a. Transfers	_____
b. Redeposits	_____
c. Loans	_____
d. Gifts	_____
Total nonincome items	_____
TOTAL INCOME RECEIPTS	_____
5. Accrual adjustments:	
a. Accounts receivable — add increase	_____
b. Accounts receivable — less decrease	_____
c. Accounts payable — less increase	_____
d. Accounts payable — add decrease	_____
Total accrual adjustment	_____
6. TOTAL INCOME	_____

**Figure 14.2** Bank Deposit Method.

ships with the subject. It will be hard for the subject to disclaim knowing a person who is called frequently by the subject.

## 14.11 Flowcharts

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There are many kinds of flowcharts that the fraud examiner can use. In many cases, the fraud examiner will probably use many kinds of flowcharts in the same case. Those most commonly used by fraud examiners are as follows:

1. **Organizational.** This flowchart identifies the chain of command or lines of authority. In criminal organizations, this is an important tool to be used during the investigation and in court as evidence. An example of this is shown in Figure 14.3.
2. **Chronological.** A chronology of events that shows people, transactions, and dates can be very useful. Its primary purpose is to identify a pattern. Once a pattern is established, the fraud examiner or investigator can project future events. The best tool in this case is to use a calendar showing the particular events.
3. **Matrix.** A matrix is a grid that shows relationships between a number of entities. This is most commonly used with telephone numbers and physical contacts, i.e., meetings. An example of this is shown in Figure 14.4.

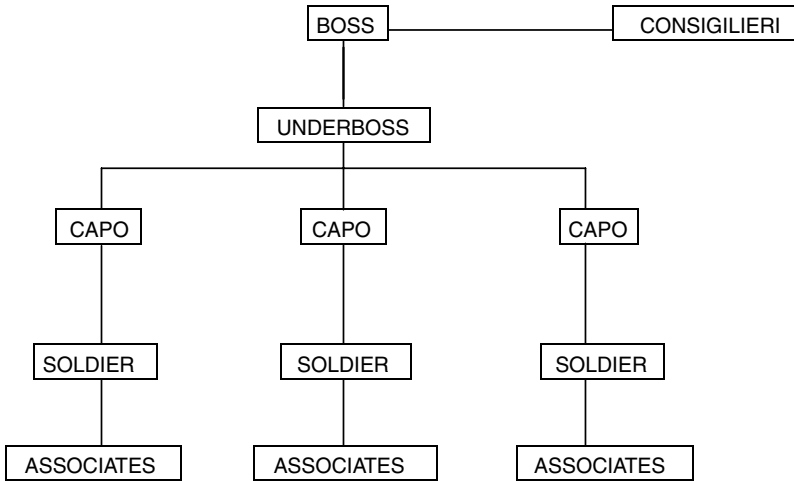


Figure 14.3 Organization flowchart.

	1	2	3	4	5	
	6	7	8	9	1	
	2	8	9	1	2	
	-	-	-	-	-	
	6	7	8	9	5	
	4	3	2	1	5	
	6	7	8	9	1	
	2	3	4	5	6	TOTAL
162-6462	X	1	3	3	8	15
278-7373	3	X	1	5	8	17
389-8284	5	3	X	2	2	12
491-9195	8	2	6	X	1	17
512-5516	1	8	2	10	X	21
TOTAL	17	14	12	20	19	82

Figure 14.4 Telephone matrix.

4. **Operational.** This flowchart shows the flow of operations. This kind of flowcharting is used by public accountants and various governmental auditors to examine internal controls. Its purpose is to illustrate the flow of documents through various departments within an organization. Internal controls are compromised when an individual or department has too much involvement in the processing of a receipt of income or payment of an expense.

### 14.12 Commission/Percentage Method

The percentage method of computing income is used primarily in sports bookmaking cases. Its primary objective is to determine income (gross receipts) earned from operations. It is generally referred to as the Vig method (vigorish). For cases involving only football

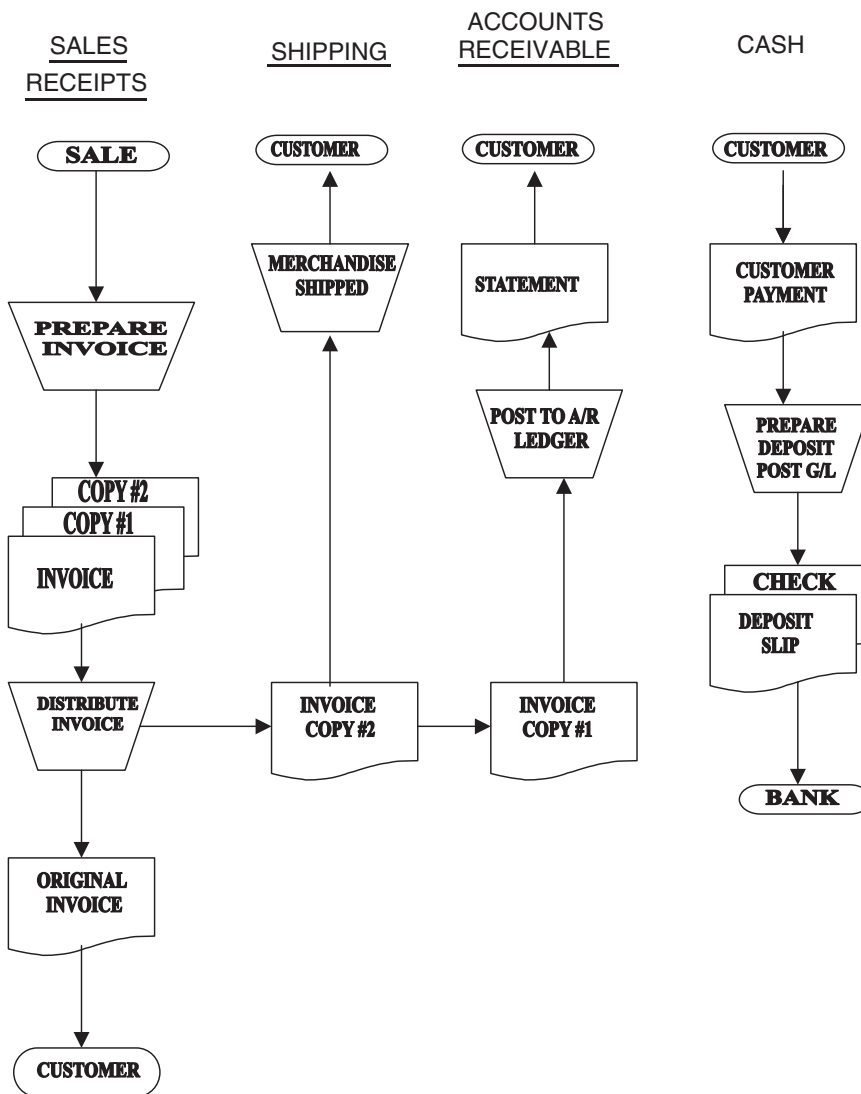


Figure 14.5 Operational flowchart.



and basketball, this percentage method is often called the 4.54 method since the percentage is 4.5454%. It is determined by the following example. Let us say that Miami and Atlanta are playing. The bookmaker takes bets equally on both sides (balances his books).

	Miami	Atlanta
Total wagers placed	\$10,000	\$10,000
Add the vigorish/juice rate	1,000	1,000
Total amount at risk by the bettors	\$11,000	\$11,000

Regardless of who wins or loses, the bookmaker will collect \$11,000 from losers and pay out \$10,000 to winners. He therefore has a \$1,000 gross profit (commission). This \$1,000 is divided by the \$22,000 (total wages of \$11,000 + \$11,000) at risk by bettors, equaling 4.5454%.

In the case of baseball and hockey bets, the bets are based on odds, which will require a different computation. If the bookmaker is using a 10-cent line, the 5% of the total base bets will approximate the gross profit. Base bet, as used here, refers to the stated bet without regards to the odds. For example, if the Los Angeles Dodgers and Atlanta Braves are playing and the line is 160 Los Angeles, then the stated wager of \$100 on Los Angeles means that the bettor is risking \$160 against the bookmaker's \$100. The \$100 is the base bet. The odds are normally based upon a 5 to 6 ratio.

### 14.13 When to Use

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The forensic accountant should use as many of these accounting techniques as possible, regardless of whether they are used in a trial. The check and deposit spreads are the basic tools of any forensic accountant or fraud examiner. They are the starting points of an examination and the building blocks to reach the final summary. The credit card spread is another building block in those cases where the subject uses them. These accounting techniques also provide leads to other financial information and establish connections with other people and entities. The subject's connections are a key to any fraud case. They are the building blocks for indirect methods, e.g., net worth and expenditure schedules.

### 14.14 Summary

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The forensic accountant has many tools that he can use. The use of those tools depends upon the circumstances of each case. Some of the tools may not be needed. If the subject has no bank accounts, then the check and deposit spreads would not be necessary. These tools consist of:

1. Tracing schedule
2. Check spread
3. Deposit spread
4. Credit card spread
5. Gross profit analysis
6. Witness list
7. Bank deposit method

8. Telephone matrix
9. Organization chart
10. Operational flowchart
11. Commission/percentage method (use for bookmakers only)





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## 15.1 Introduction

The investigator, whether of a criminal or civil case, has the monumental task of obtaining the information needed to put a case together. The subject of the investigation will not usually provide financial information and documents. This is particularly true in criminal cases. Therefore, the investigator has to turn to third parties to obtain the financial information necessary to put a case together. Some investigators, especially novice ones, do not know where to go to find financial information and documents. It can be surprising that financial information, in many cases, can be obtained fairly easily; however, in other cases, financial information cannot be obtained. It is imperative for the investigator to know where he can get the financial information needed to put his case together.

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## 15.2 Objective

The objective of this chapter is to help the investigator identify the third parties from which he can obtain the financial information and documents necessary to put his case together. Some sources will give the information upon oral or written request, while others require service of a subpoena. Yet, there are some sources that cannot give out information or documents unless authorized by a court of law. It is therefore necessary for the investigator to know what the sources require to obtain financial information and documents from them. Appendix C provides a list of Internet sites that an investigator can use to obtain information.

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## 15.3 Codes

In the following paragraphs, each source has a code that will identify who may obtain the information and documents. These codes are identified below and their explanations are given.

1. **GP — general public.** This information is available to the general public. This means anyone can obtain the information. An example of this is county public records, which show ownership of real property, mortgages, liens, judgments, tax liens, and many other items.

2. **LE — law enforcement.** This information is available only to law enforcement agencies.
3. **CO — court order.** This information can only be obtained by court order from either a state or federal court.
4. **LP — limited public access.** This information is available only to members of an organization. An example of this is credit-reporting agencies and financial institutions.

## 15.4 Federal Departments

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This section covers the various federal agencies and departments that can supply information for the investigator's case.

Description	Code	Function/Information Available
Department of Defense	LE	Maintains personnel records for civilian and military personnel (i.e., pay, training, service locations)
Defense Investigative Service	LE	Conducts background investigations and security clearances
Department of Energy	LE	Conducts background investigations and maintains personnel records
U.S. attorney	LE/CO	Prosecutes federal violations; indictments from grand juries (court orders are required for grand jury records); trial and hearing records
U.S. Border Patrol	LE	Information related to investigations of aliens and smuggling and apprehension of illegal aliens
Drug Enforcement Agency	LE	Information on drug criminals and the sale of legal and illegal drugs; drug company data
Federal Bureau of Investigation (FBI)	LE	Information on investigations of federal laws in its jurisdiction; various records (e.g., fingerprints, U.S. property)
U.S. Immigration and Naturalization Service	LE	Registered and unregistered aliens in U.S.; some financial information
Office of International Affairs	LE	Obtains information from formal requests to foreign governments through diplomatic channels
U.S. Marshal Service	LE	Investigations and arrests relating to bond defaults, escapees, parole, and probation
U.S. Department of Labor	LE	Investigates labor violations, labor unions, and pension plans
Federal Probation Office	LE	Information on current federal probationers and parolees
U.S. Postal Service	LE	Investigates postal law violations, mail fraud, and the mailing of obscene material
U.S. Department of State	LE	Information on passports, visa fraud, terrorism, and diplomatic motor vehicle registrations
U.S. Coast Guard	LP	Documents vessels over 5 net tons used in commercial operations; investigates high seas crimes
Federal Aviation Administration	LP	Aircraft title history, aircraft owners, pilot, and aircraft information
Bureau of Alcohol, Tobacco and Firearms	LE	Information on violations of firearms, explosives, bombs, and liquor; files on firearms dealers
U.S. Customs Service	LE	Information on Customs violations, smuggling activity, theft of shipments, and Currency and Monetary Instrument Report (CMIR) data bank
Internal Revenue Service	CO	Information on tax law violations; various tax returns and reports

Description	Code	Function/Information Available
Department of Defense	LE	Maintains personnel records for civilian and military personnel (i.e., pay, training, service locations)
U.S. Secret Service	LE	Information on counterfeiting, forgery, and altering government checks, currency, and bonds
Treasurer of the U.S.	LE	Provides photostats of government checks
Interstate Commerce Commission	LE	Information on individuals and companies engaged in interstate commerce
Securities and Exchange Commission	PL	Securities violations files; corporate officers and directors; quarterly bulletins; certified financial statements of corporations
Federal courts	GP	Detailed records of civil and criminal cases; also claims, bankruptcy, and tax cases

## 15.5 State Agencies and Departments

This section covers agencies and departments within the state government that can provide information for an investigator's case. It must be kept in mind that each state does not title its particular agency or department the same as another state. This section uses the state of Florida as its model. Therefore, the investigator in another state will have to compare Florida with his comparable state agency or department.

Description	Code	Function/Information Available
Department of Agriculture and Consumer Services	LE	Issues permits and inspects amusement rides, public fairs, expositions, carnivals, bazaars, and celebrations
Division of Animal Industry	LE	Investigates and enforces livestock, livestock and farm equipment thefts, and livestock movement
Division of Consumer Services	GP	Information on inquiries and complaints against businesses, and on the sellers of businesses and products
Division of Forestry	LE	Investigates fire and theft of forest and timber
Division of Public Assistance	LP	Investigates fraud by recipients and state employees of welfare programs
Medicaid Fraud Control Unit	GP	Investigates fraud by nursing homes, hospitals, pharmacies, etc.
Division of Banking	GP	Information on the charter and regulation of state financial institutions
Division of Finance and Insurance	GP	Information on licensing, regulation of mortgage brokers' finance companies, money orders, traveler's checks, and home improvements offering financing
Division of Securities	GP	Information on security dealers, agents, and advisors; has national index of agents and dealers; corporate applications
Division of Alcoholic Beverages and Tobacco	LP	Information on beverage and cigarette wholesalers and retailers
Bureau of Land Sales	GP	Maintains registration records on developers
Division of Pari-Mutuel Wagering	GP	Information on track employees' concessions and owners of racing animals
Division of Corrections, Bureau of Admission and Release	LE	Information on current and former prisoners, and parole and probation people
Department of Education	LP	Investigates violations of ethics and law by those holding teaching certificates
Department of Environmental Regulation	LE	Information on all companies involved in hazardous materials
Game and Fresh Water Fish Commission	LE	Information on wildlife law violations

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Description	Code	Function/Information Available
Department of Health and Rehabilitative Services	LE	Information on state mental hospitals and patients
Child Support Enforcement	LE	Information on parents who stop paying child support
License and certification	GP	Licenses all health care facilities, day care centers, and abortion clinics; investigates state law violations
Office of Vital Statistics	GP	Maintains records of birth, death, marriage, and divorce
Division of Drivers	LE	Maintains driver's licenses and driving record data; has photos of drivers in some states
Bureau of Records and Training	LP	Maintains copies of all accident reports in state
Division of Motor Vehicles, Bureau of Licensing and Enforcement	LP	Maintains licenses on manufacturers, importers, and distributors of all motor vehicles, including mobile homes
Bureau of Title and Lien Services	LP	Maintains records of titles, liens, and owner information
Department of Insurance and Treasurer	LP	Maintains information on insurance agents, adjusters, and bail bondsmen
Division of Consumer Services	GP	Maintains records of complaints, fines, and legal actions on unethical business practices
Bureau of Insurer Company Regulation	LP	Maintains information on insurance companies and officers
Division of Insurance Fraud	LE	Investigates fraudulent claims and activities involving companies, agents, and adjusters
Division of State Fire	LP	Licenses dealers, users, and manufacturers of explosives; investigates arson, fires, and explosives
Department of Labor and Employment Security	GP	Information on public and private labor organizations in state
Department of Law Enforcement	LE	Investigates and maintains records on criminals and trends intelligence; supplies services for local law enforcement
State medical examiner	LE	Investigates and determines cause of death
Florida Intelligence Center	LE	Maintains intelligence on criminals and supports local law enforcement
Attorney general	LP	Handles investigations of consumer complaints
Department of Lottery	LP	Information on retail applications and lottery winners of \$600 or more
Department of Natural Resources, Florida Marine Patrol	LE	Investigates saltwater violations; interdiction of narcotics smuggling on waters
Bureau of License and Motor Boat Registration	LP	Maintains boat titles and data
Licenses and permits section	LP	Maintains and issues licenses/permits for seafood dealers, dredge fills, commercial fishermen, and trolling
Division of Recreations and Parks	LE	Maintains records of state law violations on state lands
Parole Commission	LE	Information on parole status, release dates, and conditions
Department of Professional Regulation	LP	Maintains information on occupations regulated by boards
Professional boards	LP	Accountancy Acupuncture Architecture and interior design Auctioneers Barbers Chiropractic Construction industry Cosmetology Electrical contractors Geologists Funeral directors Hearing aids

Description	Code	Function/Information Available
		Landscape architects
		Land surveyors
		Massage
		Medical (physicians)
		Nursing homes
		Occupational therapists
		Opticianary
		Optometry
		Osteopathic
		Pharmacy
		Physical therapists
		Pilots
Professional boards ( <i>continued</i> )	LP	Podiatry
		Professional engineers
		Psychological services
		Real estate
		Respiratory therapists
		Veterinary medicine
Department of Revenue	LE/CO	State tax returns and information (subpoena only)
Department of State, Division of Corporations	GP	Information on corporations (profit and nonprofit)
Division of Elections, Bureau of Election Records	GP	Information forms filed by state public officials and some state employees
Department of Transportation, Bureau of Weights	LE	Information on trucking violations and the drivers
Aerial surveys section	GP	Provides aerial photos of the entire state

## 15.6 County and Municipal Agencies

This section covers departments and agencies within the county and municipal governments that can provide information for an investigator's case. Not every county or municipality has the same departments and agencies. Some counties and municipalities have departments and agencies that others do not have. Also, they do not title their departments and agencies the same. This is true even in the same state. Therefore, the investigator will have to inquire to each county or municipality as to its particular departments.

Description	Code	Function/Information Available
Aviation Department	GP	Information on airline companies and licenses to operate
Building and Zoning	GP	License and permit applications, names of contractors, and owner's identity and place of construction
Clerks of the circuit and county courts	GP	Court records on both criminal and civil cases
Library	GP	Various reference materials and copies of old books, magazines, and newspapers
Environmental services	GP	Licenses and other data on hazardous waste
Utilities	GP	Billings and payments of various utilities, i.e., water, waste, electric, and gas
Sheriff's officer or police department	LE	Arrests, accidents, gun permits, towed or repossessed autos, traffic violations
Licenses	GP	Various licenses Fishing, hunting, etc.



Description	Code	Function/Information Available
		Marriage
		Occupational
		Dog and cat
Health Department	GP	License, inspections, and other data on businesses
Voter registration	GP	Data on people registered to vote, political affiliations
State/district attorney	LE	Detailed information on criminals and criminal activities
Public records	GP	Gives detailed information on real estate, mortgages, liens, judgments, and various other items
Tax assessor/collector	GP	Records of personal and real property tax assessments and collections
Schools	LP	Maintain records of students; sometimes medical and other personal information
Social or welfare services	LP	Maintain records of recipients of welfare and other social programs
Personnel departments	LP	Maintain records on employees
Purchasing and procurement	LP	Maintains records on vendors, contracts, and others

## 15.7 Business Records

Businesses maintain records that can help in supplying data for a financial case. In most cases, these records are one of the important sources of obtaining financial information. The following is a general listing of the types of businesses that can supply financial data.

Description	Code	Function/Information Available
Abstract and title companies	GP	Provide records of real estate transactions, title policies, escrow files, maps, and plats
Bonding companies	LP	Investigative and other records on persons or firms; financial statements; identity of person on bond
Credit-reporting agencies	LP	Maintain data on people's loan histories, bank accounts, employment, insurance, and other credit actions
Department stores	LP	Maintain credit files and charge account records
Detective agency	LP	Investigative files; evidence and identifying information on clients and other parties
Fraternal, veterans, labor, social, and political organizations	LP	Membership, dues, location, and history of members
Hospital	LP	Payments, entry and release dates
Hotels and motels	LP	Identities of guests, phone calls, credit card payments, forwarding address and dates
Insurance	LP	Applications, assets being insured, ledger cards, dividends, cash values, claims refunds, and cancellations
National credit card companies	LP	Applications, charge uses, and payments, i.e., travel and entertainment, goods, and services
Telephone companies	LP	Local directories, toll calls charges and payments, list of numbers called and calling numbers
Transportation	LP	Passenger lists, fares paid, destinations, departure and arrival times and dates
Public utility company	LP	Charges and payments, service addresses, hookup and disconnect dates
Automobile dealers and manufacturers	LP	Franchise agreements, dealers' financial records, car sales, trade-ins, and service records

Brokerage companies	LP	Monthly statements, amounts and dates of buying and selling of securities, market values, and types of security and accounts
Banks and other financial institutions	LP	Names, addresses, occupations, sources of deposits and expenditures, signatures, wire transfers, safe deposit boxes, letters of credit

## 15.8 Reference Materials

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There are other sources of information that can be obtained by just going to the local library. It can give financial information as well as biographical profiles. The following are some of the more common references that can be used in helping to develop a case.

Description	Code	Function/Information Available
American Almanac of Jobs and Salaries	GP	Gives salary and wages by industry and region
Dun and Bradstreet Reference Book	GP	Gives financial and other information about various public companies
Encyclopedia of Associations	GP	Gives names, addresses, and types of organizations
Description	Code	Function/Information Available
Funk and Scott Index of Corporations and Industries	GP	Gives names, addresses, stock issues, and summary financial data
F and S International Index	GP	Gives data about companies located offshore
Moody's Bank and Finance Manual	GP	Gives data about various financial institutions
Moody's Industrial Manual	GP	Gives data about various manufacturers in the U.S.
Standard and Poor's Register of Corporations, Directors, Executives	GP	Gives data about various publicly held companies; biographical summaries of officers and directors
Thomas Register of American Manufacturers	GP	Gives data about various U.S. manufacturing companies
Better Business Bureau	GP	Maintains complaints against businesses and owners
Newspapers and magazines	GP	Provide indexes to their issues by topics and names

## 15.9 International

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Evidence from foreign countries is admissible in federal courts when it is properly authenticated. Title 18 of U.S. Code (USC) 3494 provides the procedures necessary to certify foreign documents for admission in federal criminal cases. Title 18 of USC 3492 provides that testimony of foreign witnesses may be taken by oral or written interrogatories. Many law enforcement officers and federal and state prosecutors feel that records from foreign countries are not obtainable. This is not true in every case. Some countries have various records more available than do others. This section identifies those records that are available by country. It must be kept in mind that there are federal procedures that must be followed in obtaining foreign evidence in criminal cases. Treaties sometimes provide procedures that must be followed, such as in Japan. Direct contact is forbidden. Also, proper certification must be obtained and the chain of custody properly maintained in criminal cases. Another problem in obtaining foreign evidence is whether the records are centralized or decentralized. Centralized records are located in one location. Decentralized records are located at various locations. The type of records shown below are public and identified as either centralized (CEN) or decentralized (DEC).

Country	Location	Type of Record
Anguilla	CEN	Court records
	CEN	Wills
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Birth records
	CEN	Death records
	CEN	Marriage records
	CEN	Company records
	CEN	Company bylaws
	CEN	Company financial statements
	Antigua	CEN
CEN		Wills
CEN		Patents
CEN		Trademarks
CEN		Copyrights
CEN		Corporation charter
CEN		Land transfer records
CEN		Birth records
CEN		Death records
CEN		Marriage records
CEN		Other public records
CEN		Company bylaws
Argentina	CEN	Court records
	CEN	Patents
	CEN	Trademarks
	CEN	Copyrights
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Birth records
	CEN	Death records
	CEN	Marriage records
	CEN	Public company records
	CEN	Company bylaws
CEN	Public company financial statements	
Australia	DEC	Court records
	DEC	Wills
	CEN	Patents
	CEN	Trademarks
	DEC	Commercial register
	DEC	Corporation charter
	DEC	Land transfer records
	DEC	Company records
	DEC	Company bylaws
	DEC	Company financial statements

Country	Location	Type of Record
Austria	CEN	Patents
	CEN	Trademarks
	CEN	Copyrights
	DEC	Commercial register
	DEC	Corporation charter
	DEC	Land transfer records
	DEC	Birth records
	DEC	Death records
	DEC	Marriage records
	CEN	Company financial statements
	DEC	Company bylaws
	DEC	Alien registration (U.S. only)
	Bahamas	CEN
CEN		Wills, patents, trademarks, and copyrights
CEN		Corporation charter
CEN		Land transfer records
CEN		Birth, death, and marriage records
Bahrain	CEN	Company records and bylaws
	CEN	Court records
	CEN	Corporate charter
	CEN	Commercial register
	CEN	Land transfer records
	CEN	Birth, death, and marriage records
	CEN	Bank and credit information
	CEN	Other public records
	CEN	Alien registration (U.S. only)
	Bangladesh	DEC
CEN		Patents and trademarks
CEN		Commercial register
CEN		Corporate charter
CEN		Land transfer records
CEN		Birth and marriage records
CEN		Company bylaws and financial statements
Barbados	CEN	Court records
	CEN	Wills, patents, trademarks, and copyright records
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Birth, death, and marriage records
	CEN	Other public records
Belgium	CEN	Company bylaws
	DEC	Court records
	CEN	Patents and trademarks
	CEN	Commercial register
	DEC	Corporation charter
	DEC	Land transfer records
	DEC	Company bylaws, records, and financial statements

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Country	Location	Type of Record
Belize	CEN	Court records
	CEN	Patents and trademarks
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Company bylaws
Bermuda	CEN	Court records
	CEN	Wills, patents, trademarks, and copyrights
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Birth, death, and marriage records
	CEN	Credit information
	DEC	Other public records
Bolivia	CEN	Company records
	DEC	Court records
	CEN	Patents and trademarks
	DEC	Copyrights
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Birth, death, and marriage records
	CEN	Public company records
	CEN	Public company bylaws and financial statements
Brazil	DEC	Court records
	CEN	Patents, trademarks, and copyrights
	DEC	Commercial register
	DEC	Corporation charter
	DEC	Land transfer records
	DEC	Birth, death, and marriage records
	CEN	Public company bylaws and financial statements
British Virgin Islands	CEN	Court records
	CEN	Wills, patents, trademarks and copyrights
	CEN	Corporation charter
	CEN	Birth, death, and marriage records
	CEN	Other public records
	CEN	Company bylaws
Brunei	CEN	Court records
	CEN	Patents, trademarks, and copyrights
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Land transfer records
	DEC	Birth, death, and marriage records
Burma	CEN	Company bylaw and financial statements
	DEC	Court records
	DEC	Wills
	CEN	Patents, trademarks, and copyright

Country	Location	Type of Record
Burma ( <i>continued</i> )	CEN	Commercial register
	CEN	Corporation charter
	DEC	Land transfer records
	DEC	Birth, death, and marriage records
	CEN	Alien registration (U.S. only)
	CEN	Company records, bylaws, and financial statements
Canada	DEC	Court records
	DEC	Wills
	CEN	Patents
	DEC	Commercial register
	DEC	Corporation charter
	DEC	Land transfer records
	DEC	Company bylaws
Cayman Islands	CEN	Court records
	CEN	Wills, patents, trademarks, and copyrights
	CEN	Land transfer records
	CEN	Birth, death, and marriage records
	DEC	Other public records
Channel Islands — Alderney	CEN	Court records
	CEN	Wills
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Birth, death, and marriage records
	CEN	Company records and bylaws
Channel Islands — Guersey	CEN	Court records
	CEN	Wills and trademarks
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Birth, death, and marriage records
Channel Islands — Jersey	CEN	Company records and bylaws
	CEN	Court records
	CEN	Wills, patents, and trademarks
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Land transfer records
Chile	CEN	Birth, death, and marriage records
	CEN	Company records and bylaws
	CEN	Court records
	CEN	Wills, patents, trademarks, and copyrights
	CEN	Corporation charter
	CEN	Commercial register
	CEN	Land transfer records
	DEC	Birth, death, and marriage records
	CEN	Credit information
	CEN	Public company records, bylaws, and financial statements

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Country	Location	Type of Record
Colombia	DEC	Court records
	DEC	Wills
	CEN	Patents, trademarks, and copyrights
	DEC	Commercial register
	DEC	Corporation charter
	DEC	Land transfer records
	DEC	Birth, death, and marriage records
	DEC	Credit information
	DEC	Other public records
	DEC	Alien registration (U.S. only)
	DEC	Company records, bylaws, and financial statements
Cook Islands	CEN	Court records
	CEN	Land transfer records
	CEN	Birth, death, and marriage records
	CEN	Alien registration (U.S. only)
	CEN	Company records and bylaws
Costa Rica	CEN	Court records
	CEN	Wills, patents, trademarks, and copyrights
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Birth, death, and marriage records
	CEN	Credit information
	CEN	Company bylaws
	CEN	Alien registration (U.S. only)
	CEN	Patents and trademarks
Cyprus	CEN	Corporation charter
	CEN	Birth, death, and marriage records
	CEN	Other public records
	CEN	Company records
	CEN	Company bylaws and financial statements
	DEC	Court records
	CEN	Patents, trademarks, and copyrights
Denmark	CEN	Commercial register
	CEN	Corporation charter
	DEC	Land transfer records
	DEC	Birth, death, and marriage records
	CEN	Corporation charter
Dominican Republic	CEN	Land transfer records
	CEN	Birth, death, and marriage records
	CEN	Other public records
	CEN	Patents, trademarks, and copyrights
Egypt	CEN	Commercial register
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Patents, trademarks, and copyrights

Country	Location	Type of Record
Egypt ( <i>continued</i> )	CEN	Birth, death, and marriage records
	CEN	Other public records
Fiji	CEN	Company bylaws and financial statements
	CEN	Court record
	CEN	Wills, patents, trademarks, and copyrights
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Company bylaws
Finland	DEC	Court records (limitations)
	DEC	Wills
	CEN	Patents and trademarks
	CEN	Commercial register
	DEC	Corporation charter
	DEC	Land transfer records
	CEN	Company bylaws and financial statements
France	CEN	Patents, trademarks, and copyrights
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Company bylaws and financial statements
Germany	DEC	Court records
	CEN	Patents and trademarks
	DEC	Commercial register
	DEC	Corporation charter
	DEC	Land transfer records
	DEC	Credit information
	CEN	Other public information
	DEC	Company bylaws and financial statements
Gibraltar	CEN	Court records
	CEN	Wills, trademarks, and copyrights
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Birth, death, and marriage records
Greece	CEN	Company bylaws and records
	DEC	Court records
	DEC	Wills, patents, and trademarks
	CEN	Copyrights
	DEC	Land transfer records
Grenada	DEC	Birth, death, and marriage records
	DEC	Company bylaws and financial statements
	CEN	Court records
	CEN	Wills, patents, trademarks, and copyrights
	CEN	Corporation charter
	CEN	Land transfer records

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Country	Location	Type of Record
Grenada ( <i>continued</i> )	CEN	Birth, death, and marriage records
	CEN	Other public records
	CEN	Company bylaws
Guatemala	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Birth, death, and marriage records
	CEN	Credit information (limited)
	CEN	Other public records
Haiti	CEN	Company records and bylaws
	DEC	Court records
	CEN	Patents, trademarks, and copyrights
	CEN	Corporation charter
	CEN	Land transfer records
Honduras	CEN	Birth, death, and marriage records
	CEN	Company records and bylaws
	CEN	Court records (limitations)
	CEN	Wills, patents, trademarks, and copyrights
	CEN	Commercial paper
Hong Kong	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Birth, death, and marriage records
	CEN	Other public records
	CEN	Company records and bylaws
Iceland	DEC	Court records
	CEN	Wills, patents, trademarks, and copyrights
	DEC	Commercial register
	DEC	Corporation charter
	CEN	Land transfer records
India	DEC	Birth, death, and marriage records
	CEN	Credit information
	DEC	Other public records
	DEC	Company bylaws
	DEC	Court records
Indonesia	CEN	Patents and trademarks
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Patents, trademarks, and copyrights
India	CEN	Commercial register
	DEC	Corporation charter
	CEN	Birth and death records
	CEN	Other public records
	CEN	Company bylaws
Indonesia	DEC	Court records
	CEN	Wills, patents, trademarks, and copyrights
	CEN	Commercial register

Country	Location	Type of Record
Indonesia ( <i>continued</i> )	DEC	Land transfer records
	DEC	Birth, death, and marriage records
	DEC	Other public records
Ireland	CEN	Wills, patents, trademarks, and copyrights
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Birth, death, and marriage records
	CEN	Other public records
	CEN	Company records, bylaws, and financial statements
Isle of Man	CEN	Court records
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Land transfer records
	DEC	Birth, death, and marriage records
Israel	CEN	Company records and bylaws
	DEC	Court records
	DEC	Wills
	CEN	Patents, trademarks, and copyrights
	CEN	Commercial register
	CEN	Corporation charter
	DEC	Land transfer records
	CEN	Company records, bylaws, and financial statements
Italy	DEC	Court records
	DEC	Wills
	CEN	Patents, trademarks, and copyrights
	DEC	Commercial register
	DEC	Corporation charter
	DEC	Land transfer records
	DEC	Birth, death, and marriage records
	DEC	Company records, bylaws, and financial statements
	DEC	Bankruptcy judgments
	DEC	Movie production records
	Jamaica	CEN
CEN		Patents and trademarks
CEN		Commercial register
CEN		Corporation charter
CEN		Land transfer records
CEN		Birth, death, and marriage records
CEN		Company records, bylaws, and financial statements
Japan	CEN	Court records
	CEN	Patents, trademarks, and copyrights
	DEC	Commercial register
	CEN	Corporation charter
	DEC	Land transfer records

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Country	Location	Type of Record
Japan ( <i>continued</i> )	DEC	Birth records
	CEN	Company bylaws and financial statements
Jordan	CEN	Patents, trademarks, and copyrights
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Birth, death, and marriage records
Kenya	DEC	Court records
	CEN	Patents, trademarks, and copyrights
	CEN	Commercial register
	CEN	Corporate charter
	CEN	Land transfer records
Korea	DEC	Birth, death, and marriage records
	DEC	Court records
	DEC	Commercial register
	DEC	Corporation charter
	DEC	Birth, death, and marriage records
Kuwait	CEN	Company bylaws and financial statements
	CEN	Wills and copyrights
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Land transfer records
Lebanon	CEN	Birth, death, and marriage records
	CEN	Company records and bylaws
	CEN	Land transfer records
Liberia	CEN	Birth, death, and marriage records
	CEN	Company records, bylaws, and financial statements
	DEC	Court records
	CEN	Wills
	DEC	Patents, trademarks, and copyrights
Liechtenstein	DEC	Commercial register
	CEN	Corporation charter
	DEC	Land transfer records
	DEC	Marriage records
	CEN	Patents, trademarks, and copyrights
Luxembourg	CEN	Commercial register
	CEN	Other public records
	CEN	Birth, death, and marriage records
	CEN	Patents, trademarks, and copyrights
	CEN	Commercial register
	CEN	Corporation charter
	DEC	Land transfer records
DEC	Birth, death, and marriage records	
CEN	Other public records	
CEN	Company records, bylaws, and financial statements	

Country	Location	Type of Record
Malaysia	CEN	Patents, trademarks, and copyrights
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Birth, death, and marriage records
	CEN	Company records and bylaws
Malta	CEN	Court records
	CEN	Patents, trademarks, and copyrights
	CEN	Commercial register
	CEN	Land transfer records
Mexico	CEN	Birth, death, and marriage records
	CEN	Patents, trademarks, and copyrights
	CEN	Commercial register
	CEN	Corporation charter
	DEC	Land transfer records
	CEN	Birth, death, and marriage records
Monaco	CEN	Company records
	CEN	Patents and trademarks
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Land transfer records
Nauru	CEN	Company bylaws
	CEN	Wills, patents, and trademarks
	CEN	Land transfer records
Nepal	CEN	Birth, death, and marriage records
	DEC	Court records
	CEN	Commercial register
	CEN	Corporation charter
Netherlands	CEN	Company records
	CEN	Patents, trademarks, and copyrights
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Land transfer records
	DEC	Birth, death, and marriage records
Netherlands Antilles	DEC	Company bylaws and financial statements
	CEN	Court records
	CEN	Wills, patents, trademarks, and copyrights
	CEN	Corporation charter
	CEN	Land transfer records
New Zealand	CEN	Birth, death, and marriage records
	CEN	Other public records
	CEN	Company records and bylaws
	DEC	Court records
	DEC	Wills, patents, and trademarks
	DEC	Commercial register

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Country	Location	Type of Record
New Zealand ( <i>continued</i> )	DEC	Corporation charter
	DEC	Land transfer records
	DEC	Credit information
	DEC	Company records, bylaws, and financial statements
Norway	DEC	Court records
	CEN	Patents and trademarks
	DEC	Commercial register
	DEC	Corporation charter
	DEC	Land transfer records
	CEN	Birth, death, and marriage records
	CEN	Register of ships
	DEC	Register of chattel, fishing vessels, and aircraft
Oman	CEN	Commercial register
	CEN	Bank information
Pakistan	CEN	Patents, trademarks, and copyrights
	DEC	Corporation charter
	DEC	Land transfer records
	CEN	Credit information
	DEC	Other public records
	CEN	Company records
	DEC	Company bylaws and financial statements
Panama	CEN	Court records
	CEN	Wills, patents, trademarks, and copyrights
	CEN	Corporate charter
	CEN	Land transfer records
	CEN	Birth, death, and marriage records
	DEC	Other public records
	CEN	Company bylaws
Paraguay	CEN	Court records
	CEN	Wills, patents, trademarks, and copyrights
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Birth, death, and marriage records
	CEN	Company records, bylaws, and financial statements
Peru	DEC	Court records
	CEN	Wills, patents, trademarks, copyrights
	CEN	Commercial register
	DEC	Corporation charter
	DEC	Land transfer records
	DEC	Birth, death, and marriage records
	CEN	Public company records, bylaws, financial statements
Philippines	CEN	Patents, trademarks, and copyrights
	CEN	Commercial register
	CEN	Corporation charter
	DEC	Land transfer records
	CEN	Company bylaws

Country	Location	Type of Record
Poland	CEN	Patents and trademarks
	DEC	Commercial register
Qatar	CEN	Commercial register
Romania	CEN	Patents and trademarks
	DEC	Land transfer records
St. Kitts–Nevis	CEN	Court records
	CEN	Wills, patents, trademarks, and copyrights
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Birth, death, and marriage records
	CEN	Other public records
	CEN	Company bylaw and financial statements
St. Vincent	CEN	Court records
	CEN	Wills, patents, trademarks, and copyrights
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Birth, death, and marriage records
	CEN	Other public records
	CEN	Company bylaws
Western Samoa	CEN	Court records
	CEN	Wills, patents, and trademarks
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Birth, death, and marriage records
	CEN	Alien registration (U.S. only)
	CEN	Company records and bylaws
Saudi Arabia	CEN	Trademarks and copyrights
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Company bylaws
Singapore	CEN	Court records
	CEN	Wills, patents, trademarks, and copyrights
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Birth, death, and marriage records
	CEN	Company records and bylaws
Solomon Islands	CEN	Court records
	CEN	Wills, patents, and trademarks
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Birth, death, and marriage records
	CEN	Company bylaws and financial statements

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Country	Location	Type of Record
South Africa	CEN	Court records
	CEN	Wills, patents, trademarks, and copyrights
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Birth, death, and marriage records
Spain	DEC	Patents, trademarks, and copyrights
	DEC	Commercial register
	DEC	Corporation charter
	DEC	Land transfer records
	DEC	Birth, death, and marriage records
	DEC	Company bylaws
Sri Lanka	CEN	Patents, trademarks, and copyrights
	CEN	Commercial register
	CEN	Corporation charter
	DEC	Land transfer records
	DEC	Other public records
Sudan	CEN	Company records and bylaws
	CEN	Court records
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Marriage
	CEN	Credit information
	CEN	Company bylaws
Sweden	DEC	Court records
	CEN	Patents and trademarks
	CEN	Commercial register
	CEN	Corporation charter
	DEC	Land transfer records
	DEC	Birth, death, and marriage records
	CEN	Company bylaws and financial statements
Switzerland	CEN	Patents, trademarks, and copyrights
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Birth, death, and marriage records
	DEC	Credit information
	CEN	Other public records
	CEN	Company records, bylaws, and financial statements
Syria	CEN	Commercial register
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Birth, death, and marriage records
	CEN	Company records, bylaws, and financial statements
	CEN	Company records, bylaws, and financial statements

Country	Location	Type of Record
Thailand	DEC	Court records
	DEC	Patents, trademarks, and copyrights
	DEC	Commercial register
	DEC	Corporation charter
	DEC	Land transfer records
	DEC	Birth, death, and marriage records
	DEC	Company records, bylaws, and financial statements
Trinidad and Tobago	CEN	Court records
	CEN	Patents, trademarks, and copyrights
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Birth, death, and marriage records
	DEC	Other public records
	CEN	Public company records
Tunisia	CEN	Court records
	CEN	Trademarks and copyrights
	DEC	Commercial register
	DEC	Corporation charter
	DEC	Land transfer records
	DEC	Birth, death, and marriage records
	DEC	Company bylaws
Turkey	CEN	Patents and trademarks
	CEN	Commercial register
	CEN	Land transfer records
Turks and Caicos Island	CEN	Court records
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Birth, death, and marriage records
	CEN	Other public records
	CEN	Company records and bylaws
U.K.	DEC	Court records
	CEN	Patents and trademarks
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Birth, death, and marriage records
	CEN	Other public records
	CEN	Company bylaws
Uruguay	CEN	Court records
	CEN	Wills, patents, trademarks, and copyrights
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Birth, death, and marriage records
	CEN	Company records, bylaws, and financial statements

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Country	Location	Type of Record
Vanuatu	DEC	Court records
	CEN	Patents, trademarks, and copyrights
	CEN	Land transfer records
Venezuela	DEC	Birth, death, and marriage records
	CEN	Patents, trademarks, and copyrights
	CEN	Commercial register
	CEN	Corporation charter
	CEN	Land transfer records
	CEN	Birth, death, and marriage records
Yugoslavia	CEN	Company bylaws
	CEN	Patents and trademarks
	DEC	Commercial register
	DEC	Land transfer records
	DEC	Birth, death, and marriage records

### 15.9.1 Definitions

The terms shown above have different meanings from one country to another. Commercial register can mean nothing more than the name and address of a company in some countries, while it could mean a whole biographical sketch in other countries. Company records have different meanings from one country to another. Company financial statements imply that complete financial statements are available. This may not be the case in every country, though. Some countries only require selected financial information, i.e., inventory, sales, net profit, etc. Tax return information is not available unless a treaty is in effect. Banking information is not public record in any country. In some countries, banking information is prohibited by law to be disclosed to any party or governmental body.

### 15.10 Summary

For the investigator, knowing where to find financial information is very important. This is particularly true during the initial phase of developing a case. In this phase, the investigator should get as much information as possible. A lot of information can be obtained from various public sources, which can determine if the investigator has a possible subject or case. From that point, the investigator can concentrate on the most possible subjects by obtaining more information from more difficult sources. Some sources of information are easy to get by just simply asking, while others may require administrative subpoenas or court orders. Remember, the more information that is obtained, the better. Sometimes, only one or two pieces of information can make a case.



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## 16.1 Introduction

Gambling, in its various forms, is illegal in most states. In many cases, criminal organizations control illegal gambling. Gambling has become more complicated in that many states have instituted state lotteries. Many states have these in order to obtain additional revenue without raising taxes. However, criminal organizations have tied their operations to various state lotteries. In this chapter, the most common gambling activities are discussed. Their terminology and record keeping will be discussed in detail. The gambling activities that will be addressed are:

1. **Sports bookmaking.** This explains the terminology and how sports bookmaking operates. Baseball, basketball, football, and hockey are the primary sports involved in sports bookmaking.
2. **Bingo.** Bingo halls are illegal in most states unless operated by and for the benefit of charitable organizations.
3. **Lotteries.** These are number games, policy, and similar types of wagering. The operator of the lottery pays a prize if the selected numbers appear or are published in a manner understood by the parties. The state-operated lotteries require participants to pay a certain amount for selected numbers. If the numbers are chosen, then the participants win a percentage of the “pot.” In illegal lotteries, sometimes called bolito, prizes are paid in terms of \$400 to 600 to \$1.
4. **Track betting.** Many states have various racetracks whereby betting on a race or sporting event is legal. Races usually encompass dogs and horses, while jai alai is a sporting event.

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## 16.2 Sports Bookmaking

This form of gambling involves placing bets on sport events, principally baseball, basketball, football, and hockey. Professional and collegiate teams are subjects of bettors. This form of gambling is based on the credit of the bettor. The bettor calls the bookmaker — commonly called bookie — and places his bet. If he loses, then he pays the bookie the amount of the bet plus a commission, usually 10%, at a collection site. If he wins, then he collects the amount of his bet at the same collection site. The collection site is designated in advance.

### 16.2.1 Elements

The elements of a bookmaking case are:

1. **In the Business.** The person is engaged in the business of wagering when evidence is located on the premises. This is easily established when law enforcement conducts surveillances, wiretaps, search warrants, etc. In some states, the mere fact that gambling paraphernalia is present puts the person in the business of gambling or wagering.
2. **Volume.** The volume of wagers means the size of the gross receipts. Records are normally destroyed after a week since settlement takes place once a week. The bookie destroys all records except for the amount outstanding on open accounts.
3. **Period of Operation.** The period of the operation relates to the length of time the operation was conducted. This could range from weeks to years. Direct evidence may not be available, but rather, a preponderance of the evidence may be sufficient to establish the length of time.

### 16.2.2 Federal Law

Federal law prohibits illegal gambling under Title 18, Section 1955. The Internal Revenue Code, under Section 4401, imposes an excise tax on certain gambling activities. This excise tax is usually 2% of the gross wagers, including vigorish. Federal law provides:

- a. Whoever conducts, finances, manages, supervises, directs or owns all or part of an illegal gambling business shall be fined not more than \$20,000 or imprisoned not more than five years, or both.
- b. Illegal Gambling Business means a gambling business which:
  - 1) Is a violation of the law of a State or political subdivision in which it is conducted;
  - 2) Involves five or more persons who conduct, finance, manage, supervise, direct or own all or part of such business; and
  - 3) Has been or remains in substantially continuous operation for a period in excess of 30 days or has gross revenue of \$2,000 in any single day.
- c. If five or more persons conduct, finance, manage, supervise, direct or own all or part of a gambling business, and such business operates for two or more successive days; then for the purposes of obtaining warrants for arrests, interceptions, and other searches and seizures, probable cause that the business receives gross revenue in excess of \$2,000 in any single day shall be deemed to have been established.
- d. This section shall not apply to any bingo game, lottery, or similar game of chance conducted by an organization exempt from tax under paragraph (3) of subsection (c) of section 501 of the Internal Revenue Code of 1954, as amended, if no part of the gross receipts derived from such activity inures to the benefit of any private shareholder, member, or employee of such organization except as reimbursement for actual expenses incurred by him in the conduct of such activity.

### 16.2.3 Terms

The following list of commonly used sports bookmaking terms should represent a useful reference guide for wagering investigations. It identifies and explains bookmakers' language.

1. **Dime bet.** A wager of \$1,000.
2. **Dollar bet.** A wager of \$100.
3. **Fifty-cent bet.** A wager of \$50.
4. **Four-dollar bet.** A wager of \$400.
5. **Quarter bet.** A bet of \$25 or at times \$2,500. The bettor's betting pattern or checkup can be used to establish which applies.
6. **Nickel bet.** A wager of \$500.
7. **Bettor balance sheet.** A list of amounts due to and from bettors. Usually amounts due from bettors are designated by a minus sign (-) and amounts payable to bettors are designated by a plus sign (+).
8. **Bettor list.** The bookmaker's list of bettors, which includes names, numbers, telephone numbers, and addresses. The bettor list can be used as a witness list, if necessary.
9. **Bettor number.** The number assigned to a bettor for identification.
10. **Bookmaker/bookie.** The person who for his own account accepts wagers on sporting events and charges vigorish on the bettor's losses. He may also have others who accept wagers for him.
11. **Busted out.** Refers to a bettor who is "bankrupt." In other words, he is unable to pay off.
12. **Buy a half point.** A wager placed on which the bettor purchases an extra half-point advantage over the normal line by laying 6-to-5 odds.
13. **Check a figure or check up.** The function of comparing the bettor's computation of the amount due to or from the bettor with the amount computed by the bookie. If the amount stated by the bettor agrees with the bookie's figure, then there is no problem.
14. **Checkup sheet.** Another term used for bettor balance sheet.
15. **Cheese bet.** A combination bet on the straight line and the over-under line on a given game. The Braves and Dolphins are playing. Assume the Braves are a three-point favorite, or -3, and the over-under line is 30. There are four combinations that make up a cheese bet: (1) Braves +3, over 30, (2) Braves +3, under 30, (3) Dolphins -3, under 30, and (4) Dolphins -3, over 30. A winning \$100 wager would return \$300 to the bettor. The bettor would usually have at risk \$110 or \$120, depending on the bookie with which he bet.
16. **Dog.** The team expected to lose a sporting event.
17. **Favorite.** The team expected to win a sporting event.
18. **Half-time bet.** A wager placed during the period between the first and second halves of a game. Normally, a bettor must lay 6-to-5 odds on such bets. Most bookies limit half-time lines for betting to games carried on local television.
19. **In a circle.** Refers to a homemade or uncertain line on which the size of the bet the bookmaker will accept is restricted. In some cases, it refers to buying a half point.
20. **Juice.** Another term for vigorish, which is the commission charged to losers.

21. **Lay off.** A wager placed from one bookmaker to another to reduce the bookmaker's amount of risk on a given game. If the bookmaker receives bets of \$10,000 on team A of a sports event and \$1,500 on team B, then the bookmaker will place a bet of \$8,500 on team B with another bookmaker to balance his books.
22. **Line.** The number of points given to place two opposing teams on equal footing. Adjustments may be made to influence betting on one team over the other. In baseball, hockey, and boxing, the line is expressed in terms of odds. If the odds are expressed as 8 to 5 in favor of team A, then the bookmaker dealing a 10% line will require the bettor to place \$165 against his \$100, should the bettor place a bet on team A. A bettor wishing to bet the dog, team B, will place \$100 at risk against the bookmaker's \$155. A bookmaker dealing a twenty-cent line will require \$170 against his \$100 on the favorite and place \$150 at risk against the bettor's \$100 on wagers placed on the dog.
23. **Line sheet.** A schedule of sporting events to be played with the line and changes in the line penned in.
24. **Markup.** The same as vigorish or juice.
25. **Middled.** A situation where a drastic change has been made in the line and the final score is such that it falls between two different lines used on the same game and bettors have placed bets that win on each of two teams.
26. **Mule.** A bettor that has lost (has incurred a betting liability) and refuses to pay.
27. **Off the board.** A game, for various reasons, that a bookie will not accept wagers on. Therefore, the bookie takes it "off the board."
28. **Over-under bet.** A wager placed on either over or under the total points expected to be scored in a given game. Some bookies treat a score that is exactly the same as the over-under line as a loss on the part of the bettor. Some bookies will treat a score that is exactly the same as the over-under line as a push, and the bettor loses.
29. **Parlay bet.** A combination bet on a series of teams at the normal line. All teams must win. A winner parlay bet returns to the bettor more than the amount he has at risk but less than the true odds. The true odds of a three-team parlay winning are more than 8 to 1. The amount a bettor will win on a winning \$100 three-team parlay bet is usually around \$500 to \$600. Normally, the more teams bet in a parlay bet, the greater the percentage of disadvantage to the bettor.
30. **Percentage.** The same as vigorish or juice.
31. **Phone man.** An employee or owner/bookmaker who provides betting lines, and accepts wagers over the telephone in a bookmaking operation. A phone man is often referred to as a bookmaker or bookie.
32. **Pick or pick it.** A game that is considered a toss-up. Both teams have an equal chance on a bet at pick. No points are given.
33. **Post.** These are notations of the approximate amount of wagers received on each team of a given name. Such notations are primarily made for the purpose of attempting to avoid accepting substantially more in wagers on one team over the other. The bookmaker can change the line and make wagers less desirable for one team and more desirable for the other team. However, care must be exercised to avoid making a large change. This could place the bookmaker in a position to get middled.

34. **Push.** A tie bet based on the line. A bettor bets on team A at +3. The final score is 21 on team A and 18 on team B. When the score is adjusted for the line, the effective score is 21 on team A and 21 on team B, or a tie. No one wins.
35. **Settle.** The act of paying or receiving amounts won or lost.
36. **Settlement sheet.** The same as the bettor balance sheet.
37. **Sharp.** A knowledgeable bettor.
38. **Square.** A novice bettor.
39. **Straight bet.** A bet placed on a single team at the normal line.
40. **Tax.** The same as vigorish or juice.
41. **Taxable bet.** Total amount at risk, including any charge or fee incident to the placing of a wager.
42. **Teaser bet.** A combination bet on a series of teams with extra points added to the line, depending on the number of teams in the teaser bet. Usually 6 points (half points are rounded in favor of the bookie) are added to the normal line of each team on a two-team teaser, 10 points to a three-team teaser, 12 points to a four-team teaser, etc. Some bookies may vary from this pattern and permit a total number of additional points to be spread among the teams as desired by the bettor.
43. **The book.** Usually refers to the physical location from which the bookmaker is operating.
44. **To the game.** A wager placed by a bettor on a baseball game with regard to whether the scheduled pitcher starts the game.
45. **To the pitcher.** A wager placed by a bettor on a baseball game predicted on the schedule or a certain pitcher starting the game.
46. **Vigorish.** The bookmaker's markup to provide a profit margin. Normally, the markup is 10%; that is, if a bettor places a wager of \$100 and loses, he must pay \$110. If he wins, he wins \$100. Half-time bets are normally at 6-to-5 odds or 20%. Some bookmakers will permit a bettor to place a wager on a game with an extra half-point advantage, if the bettor will lay 6-to-5 odds. Sometimes, the bookmaker will require 6-to-5 odds. In the case of baseball, if the bookmaker is dealing a 10-cent line, there will be a \$10 spread between the amount a bettor must place at risk on a stated bet of \$100, if he bets on the favorite team, and what he can expect to receive if he bets on the underdog. If the true odds on a game between team A and team B are 8 to 5 in favor of team B, and if a bettor places a stated bet of \$100 on team B, he must pay \$165 to the bookmaker if he loses; he will receive \$100 if he wins. Conversely, if the bettor places a stated bet of \$100 on team A and wins, he will win only \$155; he must pay \$100 if he loses. The spread on a 20-cent line would be \$20 on a stated bet of \$100. The bookmaker would state the line at team B minus 65, or team A minus 165. At times, when the odds reach approximately 2 to 1, runs may be given rather than the foregoing.
47. **With a hook.** The adding of half a point to the line, i.e., "3 with a hook" means 3½.

#### 16.2.4 Teams

Sports betting encompasses professional and collegiate teams. The sports most commonly used for wagering are baseball, basketball, football, and hockey. The following paragraphs list the teams and their hometowns by sport.

1. **Professional baseball.** Professional baseball teams are grouped into two leagues: American and National. The two leagues with their teams are listed below.

Team Name	Location
A. American League	
Baltimore Orioles	Baltimore, MD
Boston Red Sox	Boston, MA
California Angels	Anaheim, CA
Chicago White Sox	Chicago, IL
Cleveland Indians	Cleveland, OH
Detroit Tigers	Detroit, MI
Kansas City Royals	Kansas City, MO
Milwaukee Brewers	Milwaukee, WI
Minnesota Twins	Minneapolis, MN
New York Yankees	Bronx, NY
Oakland A's	Oakland, CA
Seattle Mariners	Seattle, WA
Texas Rangers	Arlington, TX
Tampa Bay Devil Rays	Tampa, FL
Toronto Blue Jays	Toronto, Ontario
B. National League	
Arizona Diamondbacks	Phoenix, AZ
Atlanta Braves	Atlanta, GA
Chicago Cubs	Chicago, IL
Cincinnati Reds	Cincinnati, OH
Colorado Rockies	Denver, CO
Florida Marlins	Miami, FL
Houston Astros	Houston, TX
Los Angeles Dodgers	Los Angeles, CA
Milwaukee Brewers	Milwaukee, WI
Montreal Expos	Montreal, Quebec
New York Mets	Flushing, NY
Philadelphia Phillies	Philadelphia, PA
Pittsburgh Pirates	Pittsburgh, PA
St. Louis Cardinals	St. Louis, MO
San Diego Padres	San Diego, CA
San Francisco Giants	San Francisco, CA

2. **Professional basketball.** Professional basketball only has one league: the National Basketball League. Its teams are as follows:

Team Name	Location
Atlanta Hawks	Atlanta, GA
Boston Celtics	Boston, MA
Chicago Bulls	Chicago, IL
Charlotte Bobcats	Charlotte, NC
Cleveland Cavaliers	Richfield, OH
Dallas Mavericks	Dallas, TX
Denver Nuggets	Denver, CO
Detroit Pistons	Pontiac, MI
Golden State Warriors	Oakland, CA
Houston Rockets	Houston, TX

Team Name	Location
Indiana Pacers	Indianapolis, IN
Kansas City Kings	Kansas City, MO
Los Angeles Clippers	Los Angeles, CA
Los Angeles Lakers	Inglewood, CA
Miami Heat	Miami, FL
Milwaukee Bucks	Milwaukee, WI
Minnesota Timberwolves	St. Paul, MN
New Jersey Nets	E. Rutherford, NJ
New Orleans Hornets	New Orleans, LA
New York Knickerbockers	New York, NY
Orlando Magic	Orlando, FL
Philadelphia 76ers	Philadelphia, PA
Phoenix Suns	Phoenix, AZ
Portland Trail Blazers	Portland, OR
Sacramento Kings	Sacramento, CA
San Antonio Spurs	San Antonio, TX
Seattle Super Sonics	Seattle, WA
Toronto Raptors	Toronto, Canada
Utah Jazz	Salt Lake City, UT
Vancouver Grizzlies	Vancouver, Canada
Washington Wizards	Landover, MD

3. **Professional football.** There are two major professional football leagues: National and Canadian. The two leagues along with their teams are listed below.

Team Name	Location
A. National Football League	
Arizona Cardinals	Phoenix, AZ
Atlanta Falcons	Suwanee, GA
Baltimore Ravens	Baltimore, MD
Buffalo Bills	Orchard Park, NY
Carolina Panthers	Charlotte, NC
Chicago Bears	Chicago, IL
Cincinnati Bengals	Cincinnati, OH
Cleveland Browns	Cleveland, OH
Dallas Cowboys	Dallas, TX
Denver Broncos	Denver, CO
Detroit Lions	Pontiac, MI
Green Bay Packers	Green Bay, WI
Houston Texans	Houston, TX
Indianapolis Colts	Indianapolis, IN
Jacksonville Jaguars	Jacksonville, FL
Kansas City Chiefs	Kansas City, MO
Miami Dolphins	Miami, FL
Minnesota Vikings	Eden Prairie, MN
Tennessee Titans	Nashville, TN
New England Patriots	Foxboro, MA
New Orleans Saints	New Orleans, LA
New York Giants	E. Rutherford, NY
New York Jets	New York, NY

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Team Name	Location
A. National Football League ( <i>continued</i> )	
Oakland Raiders	Oakland, CA
Philadelphia Eagles	Philadelphia, PA
Pittsburgh Steelers	Pittsburgh, PA
St. Louis Rams	St. Louis, MO
San Diego Chargers	San Diego, CA
San Francisco 49ers	Redwood City, CA
Seattle Seahawks	Kirkland, WA
Tampa Bay Buccaneers	Tampa, FL
Washington Redskins	Washington, D.C.
B. Canadian Football League	
B. C. Lions Football Club	Surrey, BC
Calgary Stampeders	Calgary, Alberta
Edmonton Eskimos	Edmonton, Alberta
Hamilton Tiger-Cats	Hamilton, Ontario
Montreal Concordes	Montreal, Quebec
Ottawa Rough Riders	Ottawa, Ontario
Saskatchewan Roughriders	Regina, Saskatchewan
Toronto Argonauts	Toronto, Ontario
Winnipeg Blue Bombers	Winnipeg, Manitoba

4. **Professional hockey.** There is only one hockey league: the National Hockey League. Its teams are as follows:

Team Name	Location
Anaheim Mighty Ducks	Anaheim, CA
Atlanta Thrashers	Atlanta, GA
Boston Bruins	Boston, MA
Buffalo Sabres	Buffalo, NY
Calgary Flames	Calgary, Alberta
Carolina Hurricanes	Charlotte, NC
Chicago Black Hawks	Chicago, IL
Colorado Avalanche	Denver, CO
Columbus Blue Jackets	Columbus, OH
Dallas Stars	Dallas, TX
Detroit Red Wings	Detroit, MI
Edmonton Oilers	Edmonton, Alberta
Florida Panthers	Sunrise, FL
Los Angeles Kings	Inglewood, CA
Minnesota North Stars	Bloomington, MN
Montreal Canadiens	Montreal, Quebec
Nashville Predators	Nashville, TN
New Jersey Devils	E. Rutherford, NJ
New York Islanders	Uniondale, NY
New York Rangers	New York, NY
Ottawa Senators	Ottawa, Canada
Philadelphia Flyers	Philadelphia, PA
Phoenix Coyotes	Phoenix, AZ
Pittsburgh Penguins	Pittsburgh, PA
Quebec Nordiques	Charlesbourg, Quebec
St. Louis Blues	St. Louis, MO

Team Name	Location
San Jose Sharks	San Jose, CA
Tampa Bay Lightning	Tampa, FL
Toronto Maple Leafs	Toronto, Ontario
Vancouver Canucks	Vancouver, BC
Washington Capitals	Landover, MD

5. **Collegiate football.** Many colleges have football teams. The colleges and universities are members of the National Collegiate Athletic Association (NCAA). The NCAA makes the rules for collegiate football. The college teams that are mostly used by bookmakers are those of the universities and colleges listed below.

Team	University/College
Air Force Falcons	Air Force Academy
Akron	Akron State College
Alabama	University of Alabama
Albright	Albright University
Arizona	University of Arizona
Arizona State	Arizona State University
Arkansas	University of Arkansas
Army	U.S. Military Academy
Auburn	Auburn University
Ball State	Ball State College
Baylor	Baylor University
Bethune-Cookeman	Bethune-Cookeman College
Boston College	Boston College
Brigham Young	Brigham Young University
Brown	Brown University
Cal	California University
Carroll	Carroll College
Central Florida	University of Central Florida
University of Chicago	University of Chicago
University of Cincinnati	University of Cincinnati
Citadel	Citadel Military Academy
Clemson	Clemson University
Colgate	Colgate College
Colorado	University of Colorado
Colorado State	Colorado State University
Columbia	Columbia University
Cornell	Cornell University
Dartmouth	Dartmouth College
Duke	Duke University
East Carolina	University of East Carolina
Florida A&M	Florida A&M University
Florida Atlantic University Owls	Florida Atlantic University
Florida Gators	University of Florida
Florida Seminoles	Florida State University
Fresno	Fresno University
Fullerton	Fullerton State College
Georgia	University of Georgia
Georgia Tech	Georgia Institute of Technology
Harvard	Harvard University
Hawaii	University of Hawaii
Holy Cross	Holy Cross University

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Team	University/College
Houston	University of Texas
Illinois	University of Illinois
Indiana	University of Indiana
Iowa	University of Iowa
Iowa State	Iowa State University
Kansas	University of Kansas
Kansas State	Kansas State University
Kent State	Kent State University
Kentucky	University of Kentucky
LA Tech	LA Institute of Technology
LaFayette	Lafayette College
Las Vegas	University of Nevada, Las Vegas
Louisiana	Louisiana State University
Louisville	Louisville University
Maryland	University of Maryland
Memphis State	Memphis State University
Methodist	Southern Methodist University
MIT	Massachusetts Institute of Technology
Miami	University of Miami, Ohio
Miami Hurricanes	University of Miami, Florida
Michigan	University of Michigan
Michigan State	Michigan State University
Minnesota	University of Minnesota
Mississippi	University of Mississippi
Missouri	University of Missouri
Navy	U.S. Naval Academy
Nebraska	University of Nebraska
Nevada	University of Nevada
New Mexico	University of New Mexico
North Carolina	University of North Carolina
North Carolina State	North Carolina State University
Northwestern	Northwestern University
Notre Dame	Notre Dame University
Ohio	University of Ohio
Ohio State	Ohio State University
Oklahoma	University of Oklahoma
Oklahoma State	Oklahoma State University
Old Miss	Mississippi State University
Oregon	University of Oregon
Oregon State	Oregon State University
Penn State	Pennsylvania State University
Penn	University of Pennsylvania
Pitts	University of Pittsburgh
Princeton	Princeton University
Purdue	Purdue University
Rice	Rice University
Rutgers	Rutgers University
San Diego State	San Diego State University
San Jose State	San Jose State University
South Carolina	South Carolina University
Southern Cal	University of Southern California
SW Louisiana	SW Louisiana University
Stanford	Stanford University
Syracuse	Syracuse University

Team	University/College
Temple	Temple University
Tennessee	University of Tennessee
Texas	Texas A&M University
Texas–El Paso	University of Texas, El Paso
Texas Tech	Texas Institute of Technology
Toledo	University of Ohio, Toledo
Tulane	Tulane University
Tulsa	Tulsa University
UCLA	University of California, Los Angeles
Utah State	Utah State University
Vanderbilt	Vanderbilt University
VMI	Virginia Military Academy
Utah	University of Utah
Virginia	University of Virginia
Virginia Tech	Virginia Institute of Technology
Wake Forest	Wake Forest University
Washington	George Washington University
Washington	University of Washington
Washington State	Washington State University
Wesleyan	Wesleyan University
West Michigan	West Michigan University
West Virginia	West Virginia University
Wisconsin	University of Wisconsin
Wyoming	University of Wyoming
Yale	Yale University

### 16.2.4.1 *Baseball*

Baseball is more complicated for a person to learn. In baseball, there are two lines: the money line and the western line. There are also totals, or over and under, on each game. The money line is also called the pitcher's line because the price of the favorite depends on who is pitching, or it is also called the dime line because there is a \$10 difference between the favorite price and the underdog price. When a player bets the money line, the pitcher must pitch, both of them, or there is no action (no bet). The only time a bettor receiving the money line has a bet is on the occasion that one of the two pitchers on the list does not pitch when the bettor states before the bet that he wants action on the plays. Action means that if a pitcher does not go, then the bettor would have a bet at an adjusted price according to the strength of the new pitcher. The following chart illustrates all possible money lines and what the bet would be on the favorite and the underdog in terms of \$100.

Possible	Money Line	Bet	Win
Favorite	–110	110	100 on favorite
Underdog	Even	100	100 on underdog
Favorite	–115	115	100 on favorite
Underdog	+105	100	105 on underdog
Favorite	–120	120	100 on favorite
Underdog	+110	100	110 on underdog
Favorite	–125	125	100 on favorite
Underdog	+115	100	115 on underdog
Favorite	–130	130	100 on favorite
Underdog	+120	100	120 on underdog

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Possible	Money Line	Bet	Win
Favorite	-135	135	100 on favorite
Underdog	+125	100	125 on underdog
Favorite	-140	140	100 on favorite
Underdog	+130	100	130 on underdog
Favorite	-145	145	100 on favorite
Underdog	+135	100	135 on underdog
Favorite	-150	150	100 on favorite
Underdog	+140	100	140 on underdog
Favorite	-155	155	100 on favorite
Underdog	+145	100	145 on underdog
Favorite	-160	160	100 on favorite
Underdog	+150	100	150 on underdog
Favorite	-165	165	100 on favorite
Underdog	+155	100	155 on underdog
Favorite	-170	170	100 on favorite
Underdog	+160	100	160 on underdog
Favorite	-175	175	100 on favorite
Underdog	+165	100	165 on underdog
Favorite	-180	180	100 on favorite
Underdog	+170	100	170 on underdog
Favorite	-185	185	100 on favorite
Underdog	+175	100	175 on underdog
Favorite	-190	190	100 on favorite
Underdog	+180	100	180 on underdog
Favorite	-200	200	100 on favorite
Underdog	+185	100	185 on underdog
Favorite	-210 <sup>a</sup>	210	100 on favorite
Underdog	+190	100	190 on underdog
Favorite	-220	220	100 on favorite
Underdog	+200	100	200 on underdog
Favorite	-230	230	100 on favorite
Underdog	+210	100	210 on underdog
Favorite	-240	240	100 on favorite
Underdog	+220	100	220 on underdog
Favorite	-250	250	100 on favorite
Underdog	+230	100	230 on underdog
Favorite	-260	260	100 on favorite
Underdog	+240	100	240 on underdog

<sup>a</sup>Note that 210 or more becomes a \$20 difference instead of \$10. This is done so the bookmaker's vigorish/juice stays the same rate. When there is no favorite or pick, then both teams are the same or shown as favorite 105 and underdog 100. Also, note that the favorite always uses the minus sign, while the underdog uses the plus sign.

One can understand how baseball betting works by going through an example. A sports line service provides the line on the Mets vs. Cincinnati as follows:

Mets	160
Cincinnati	

The Mets are the favorite since the price and the minus (–) sign are by their name. The Mets are minus 160. This means that for every \$100 a person wants to win on the Mets, the bettor must risk \$160. If the bettor bets on the Mets for \$100 and loses, then he owes the bookmaker \$160. If he wins, then the bookmaker owes him \$100. The bookmaker's bettor sheet would show:

Team	Vigorish	Bet	Win
Mets	-60	160	100

The team column tells what team the bettor is placing his bet on to win. The vigorish column tells the bookmaker what amount of vigorish/juice he is expected to win. The bet column is the amount wagered by the bettor. This is the full amount the bettor will have to pay the bookmaker if he loses. The win column shows the amount that the bookmaker will owe the bettor if the bettor wins.

Using the same line and teams, the bettor places a wager on the underdog, Cincinnati. The underdog is always \$100 less than the favorite, or +150. Here, the bettor is risking \$100 to make \$150. The bookmaker's bettor sheet would show:

Team	Vigorish	Bet	Win
Cincinnati	+50	100	150

Now, let us go through another example, but with a different bet amount. The bettor wants to place a wager on the Mets for 300. The bookmaker's bettor sheet would show:

Team	Vigorish	Bet	Win
Mets	-60	480	300

This requires computation on the part of the bookmaker. The calculation is based on the line of 160 to 100. So the bettor wants 300. This corresponds to  $100 \times 3 = 300$ . The bet would be  $160 \times 3 = 480$ . The bettor risks 480 to win 300. This rule also applies to the other team. If the bettor wants to place 300 on Cincinnati, the underdog, the computation changes as follows:

Team	Vigorish	Bet	Win
Cincinnati	+50	300	450

The win column will show the amount the bettor would win. It is computed by  $150 \times 3 = \$450$ . The bet column is based on the ratio of  $100 \times 3 = \$300$ .

The basic rules, from the examples above, are (1) it is impossible to win more on a favorite than you are betting, and (2) it is impossible to bet more on an underdog than the bettor can win.

A parlay is picking two or more teams to win their games. A parlay is for a set amount that the bettor wants. If the bettor wins, the bookmaker must figure it out by the prices (vigorish or juice). In a parlay, all teams must win; otherwise, the bettor loses.

The following examples illustrate a parlay.

The line for two games is:

Mets	-160
Cincinnati	150
Los Angeles	-120
Miami	110

The bettor places a wager of \$200 parlay on the Mets and Miami. The bookmaker's bettor sheet would show:

Team	Vigorish	Bet	Win
Mets	-60		
Miami	+10	200 Parlay	

Notice that the Mets are a favorite, while Miami is the underdog. Remember, all teams in a parlay must win before the bettor can win. If one team loses and the other wins, the bettor loses. In this example, if both teams win, then the bettor wins the following by the rules shown above:

Team	Vigorish	Bet	Win
Mets	-60	320	200
Miami	+10	200	220
Total			420

If one or both of the teams loses, then the bettor has to pay the bookmaker the following:

Team	Vigorish	Bet	Win
Mets	-60	320	200
Miami	+10	220	240
Total		540	

A round-robin is a group of two-team parlays written in a shorter and easier way. A round-robin must have at least three teams. The three-team round-robin is the same as three two-team parlays. To illustrate a round-robin and three two-team parlays, the following example is given.

The line is given below on three games:

Mets	-160	Los Angeles	-120	Boston	-140
Cincinnati	150	Miami	110	Braves	130

The round-robin must have at least three teams. The bettor calls the bookmaker and places a 200 round-robin wager as follows:

Team	Vigorish	Bet	Win
Mets	-60		
Miami	+10		
Boston	-40	200 round-robin	

Notice that two teams are favorites while one team is an underdog. Three two-team parlays would appear on the bookmaker's bettor sheet as follows:

Team	Vigorish	Bet	Win
Mets	-60		
Miami	+10	200 parlay	
Mets	-60		
Boston	-40	200 parlay	
Miami	+10		
Boston	-40	200 parlay	

For the bettor to win, all teams must also win. If any team loses, then the bettor loses. In a round-robin, the bettor would win the amount shown below when all teams win.

Team	Vigorish	Bet	Win
Mets	-60	320	200
Miami	+10	200	220
Boston	-40	280	200
Total			620

If the bettor loses, the bookmaker would collect the following:

Team	Vigorish	Bet
Mets	-60	320
Miami	+10	200
Boston	-40	280
Total		800

Bettors will also make wagers based on points either over or under the line. When points are placed either over or under the line, then the bets change to only three possible combinations:

- 120 to 100
- 110 to 100
- 100 to 100, or even money

These three combinations are called flat, over, or under and are defined as follows:

- Flat (F)** — When the total line is flat, the bettor goes either over (O) or under (U); he must lay 110 to win 100. Flat has no favorite.
- Over (O)** — When the total line is favored over (O), the bettor must bet 120 to 100 because the over (O) is the bookmaker’s favorite; if he goes under (U), then the bet is 100 to 100 because the bettor is going against the bookmaker’s favorite.
- Under (U)** — When the total line is favored under (U) (the bettor wagers under), then he must lay 120 to 100 because the under is the favorite. If the bettor wagers over, he lays 100 to 100 because the bettor is going against the favorite.

To illustrate, let us assume the same example as quoted before. The line is:

Mets	-160
Cincinnati	150

The bettor wants the Mets at over the eighth for \$200. The bookmaker’s sheet would show:

Team	O/U	Bet	Win
Mets	O 8	240	200

This shows that the bettor must pay \$120 if he loses, or he wins \$100. Now, let us assume that the bettor wagers the Mets under the eighth for \$200. The bookmaker’s sheet should reflect:



Team	O/U	Bet	Win
Mets	U 8	200	200

In this instance, the favorite is the Mets. Therefore, the odds are 100 to 100, or even money. Now, it is assumed that the bookmaker has no favorite. This is called a flat. In other words, there is no favorite or underdog. In a nonfavorite situation, the odds are always 110 to 100. The bettor calls and wagers 8 points under for 200. The bookmaker's tally sheet will show:

Team	O/U	Bet	Win
Mets	U 8	220	200

If the bettor wins, he receives \$200. If the bettor loses, he pays \$220.

The points, both over and under, can have half points. Many bookmakers use the minus (-) sign to represent a half point, sometimes called half run. For example:

$$7- = 7\frac{1}{2} \text{ runs}$$

The bettor calls up and wants to put 7- on the Mets for \$300. The line is:

Mets	-160	7- U
Cincinnati	150	

The bettor in this illustration wants 7½ points under on the Mets for \$300. The bookmaker's tally sheet should show:

Team	Bet	Win
Mets U 7-	360	300

In this illustration, the bettor must lay 120 to 100 since the team is the bookmaker's favorite.

When the bettor places bets in a parlay or round-robin using points and half points (runs), the bookmaker's tally sheet would probably look like the following using \$100:

Line		Team	Bet	Win
Mets	-160	Mets U 8 U	120	100
Cincinnati	150			
Los Angeles	-120	Miami O 7- F	110	100
Miami	110			
Boston	-140	Boston U 6 O	100	100
Braves	130			

The line is shown here as reference; otherwise, it would not be reflected on the bookmaker's sheet. In the above example, the Mets are given as eight runs for under. This is the bookmaker's favorite. In Miami O 7- F, the bookmaker has no favorite or underdog. In Boston U 6 O, the bettor is betting opposite the bookmaker. This is called an even bet. The rule of thumb is that when the bettor places a bet in favor of the bookmaker's choice, this is a favorite bet. When the bettor places a bet opposite of the bookmaker's choice, this is an even bet. When the bettor places a bet that is neither a favorite or an underdog to the bookmaker, it is a flat.

When the bookmaker does not know who is pitching in a game, he will have four prices or odds. The bookmaker's sheet would read like the following example:

Team	Pitcher	Odds	Odds	Odds	Odds
SF Giants	Swan, Reuschel	PS-S	-8	G-S	G-R
Braves	P. Smith, Glavine	20	R-PS	35	15

The price is on the line that is the bookmaker's favorite. Above or below the price (odds) are the pitchers. When a bettor calls, the bookmaker would say Braves' P. Smith is -20 over Swan, but Giants' Reuschel is -8 over P. Smith, and Braves' Glavine is 35 over Swan and -15 over Reuschel.

If the bettor does not care who pitches and places a bet, using the odds above, for \$1,000 on the SF Giants, then the bookmaker's tally sheet would show the following breakdown:

Team	Price	Pitcher	Bet	Win
Giants	+10	PS-S	1000	1100
	-08	R-PS	1080	1000
	+25	G-S	1000	1250
	+05	G-R	1000	1050

If the bettor places a bet on the Braves' doubleheader (two games by the same teams) with no pitcher identified, then the bookmaker's tally sheet would show the following:

Team	Price	Pitcher	Bet	Win
Braves	-20	PS-S	1200	1000
	-02	R-PS	1020	1000
	-35	G-S	1350	1000
	-15	G-R	1150	1000

This bet would apply to both games.

Using the same teams and odds, the bettor places a \$100 bet on the Giants' Reuschel, but does not care who pitches against him. The bookmaker's tally sheet would reflect:

Team	Price	Pitcher	Bet	Win
Giants	-08	PS	108	100
	+05			

The bettor could change his odds or price on game 2 of a double-hitter. The bettor bets on the Braves for \$200. The tally sheet would show:

Team	Price	Pitcher	Bet	Win
Braves	-20	PS-S	240	200
	-02	R-PS	204	200
	-35	G-S	270	200
	-15	G-R	230	200

The bettor wants the Braves if Swan pitches, for \$1,000. Swan is the Giants' pitcher. The tally sheet would show:

Team	Price	Pitcher	Bet	Win
Braves	-20	PS	1200	1000
(Swan)	-35	G	1350	1000

This section has given a summary of how baseball sports betting works.

### 16.2.4.2 Football

Football only involves a point spread and a total. All bets are 110-to-100 odds. The only time a football bet is not 110 to 100 is when a player buys a half point or plays a gimmick. Like baseball, football has favorites and underdogs. Minus (-) points are always the bookmaker's favorite, plus (+) points are always the underdog, and a pick or even game has no favorite. The point spread can also have half points. The bookmaker gives the bettor the favorite team, the point spread (expressed in minus points), and the total. For example:

Phoenix	5 and 41
49ers	3 and 39

For every \$100 a bettor places to win a football game, he must risk \$110 or 10%. The 10% is called juice or vigorish, which the bookmaker earns. The bookmaker's tally sheet will always have as a minimum the bettor's number, team, point spread, and bet amount. For example:

Team	Points	Bet
Buffalo	-30	500 favorite
Dolphins	+3	400 underdog

A parlay is picking two or more teams to win. A parlay is a set amount. How much the bettor wins depends on how many teams he puts in the parlay. The bettor must win all picks in order for the parlay to win. One loser will cause the whole parlay to lose. The bettor tells the bookmaker that he wants \$100 parlay on the 49ers and Miami. The tally sheet would read:

Team	Points	Bet
49ers	-3	
Miami	+4	100 P

The bettor would win \$260 or  $\$100 \times 2.6 = \$260$ .

The bettor can use the total as well as points. For example:

Team	Points	Bet
Rams	-6	
Denver	O 41	1,000 P

The bettor would win \$2,600, or  $\$1,000 \times 2.6 = \$2,600$ . This is based on the odds of 13 to 5, or amount times 2.6.

The odds are set by the bookmaker for parlays and round-robin bets. These are normally as follows, but the bookmaker can change them:

Team	Odds
2	13-5, or amount times 2.6
3	6-1, or amount times 6
4	10-1, or amount times 10
5	15-1, or amount times 15

In a three-team parlay, the bettor wants the Rams, Denver, and the Dolphins under for \$300. The tally sheet would read:

Team	Points	Bet
Rams	-2	
Denver	U 39	
Dolphins	-5	300 P

The bettor would win \$1,800, or  $\$300 \times 6 = \$1,800$ . The odds are 10 to 1.

A round-robin is a group of two-team parlays playing three games. The bettor wants \$100 round-robin on the Rams, Denver, and the Dolphins for \$100. The tally sheet reads:

Team	Points	Bet
Rams	+6	
Denver	+2	
Dolphins	+5	100 RR

Notice, the bettor is betting on the underdog. A round-robin would be the same as writing three parlays as follows:

Team	Points	Bet
Rams	+6	
Denver	+2	100 P
Rams	+6	
Dolphins	+5	100 P
Denver	+2	
Dolphins	+5	100 P

A three-team round-robin has three two-team parlays.

A four-team round-robin has six two-team parlays.

A five-team round-robin has 10 two-team parlays.

The only time a football bet is not 110-to-100 odds is when a bettor wants to buy a half point in his favor — then it will cost the bettor 120-to-100 odds.

If the bettor is betting a favorite and wants a half point, then this half-point spread will be lower by a half point.

Team	Points	Bet	Win
Denver	-2	120	100

If the bettor is betting on an underdog and wants to purchase a half point, the spread will go up by a half point:

Team	Points	Bet	Win
Dolphins	+2-	240	200

This bet is figured out by taking the amount times 1.2 equals 240.

A bettor can also buy half points on totals:

O is just like buying on a flaw.

U is just like buying on a dog.

Denver is 40. The bettor wants to buy a half point and go over for 300. The bettor gets the total at 39-:

Team	Points	Bet	Win
Denver	O 39-	360	300

The bettor wants to buy a half point and go under for 500. The total goes up to 40-:

Team	Points	Bet	Win
Denver	U 40-	600	500

Note that the only time the 120-to-100 odds on buying a half point change is when a customer is buying off a round-robin. It then costs the bettor 125 to 100, or the amount times 1.25. Also note that the bettor can buy a full point; however, it will cost him 140 to 100, or the amount times 1.4.

Teaser bets are only used in the sport of football. Bookmakers get many teaser bets, and most bookmakers use the following chart:

Team No.	6 Points	6 Points	7 Points
2	100-100	110-100	120-100
3	100-180	100-160	100-150
4	100-300	100-250	100-200
5	100-450	100-400	100-350

There are 12 possible combinations for a teaser using the above chart. The breakdown is as follows:

Team and Points	Odds
2 teamer 6	100-100
2 teamer 6-	110-100
2 teamer 7	120-100
3 teamer 6	100-180
3 teamer 6-	100-160
3 teamer 7	100-150
4 teamer 6	100-300
4 teamer 6-	100-250
4 teamer 7	100-200
5 teamer 6	100-450
5 teamer 6-	100-400
5 teamer 7	100-350

Teasers are gimmicks that offer to give the bettor another betting choice in which the bookmaker allows the bettor to add points to the bettor's team's point spread for a certain

price. The bettor wants a two-team teaser for 6 points for 100 on Denver at  $-3$  and the Dolphins at  $+5$ .

Team	Points	Teaser Points	Points Used
Denver	$-3$	6	+3
Dolphins	$+5$	6	+11

The bettor wants a two-team teaser for 7 points for 400 using Denver and the Dolphins. The points are Denver  $-3$  and the Dolphins  $-3$ .

In this case, the bettor is using points of  $+3$  on Denver and  $+4$  on the Dolphins. The bookmaker's tally sheet would read as follows:

Team	Points	Bet	Win
Denver	$+3$	480	400
Dolphins	$+4$	480	400 T

In a three-team teaser, the bookmaker's tally sheet would read as follows:

Team	Points	Bet	Win
Denver	$+2$		
Dolphins	$-1/2$		
Dallas	$+2$	200	360

### 16.2.4.3 Basketball

Basketball is identical to football. If the fraud examiner knows football, then he will know basketball, since the rules are the same. The point spread is the line, which is rated to equal betting action on each team of a game. A total is based on an average of total points scored. Like football, basketball odds are 110 to 100.

## 16.3 Lottery

Lottery is a game of chance whereby bettors place bets on numbers that are randomly selected from some identified, independent source. In some areas, this form of betting is called bolito. In essence, the bettor picks a two- or three-digit number at random and places a bet of anywhere from \$1 or more with a writer. If the bettor's number is selected, then the bettor wins anywhere from \$30 to \$600, depending on the digits and betting volume.

### 16.3.1 Terminology

Lottery operators and bettors have their own terminology. These terms are defined as follows:

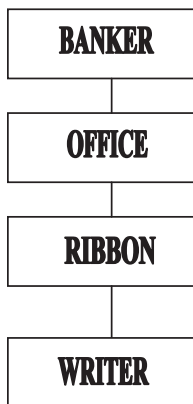
1. **Add-back.** An outstanding previous week's balance from a writer or ribbon. This amount is added back to the net of the current week's summary.
2. **Bag man or pickup man.** A person who picks up monies generated from lottery activity from ribbons or writers or carries out funds needed to cover hits.

3. **Banker.** One who directs, finances, controls, and receives the final profit from a lottery.
4. **Box bet.** A wager placed on any permutation of a given three-digit number. Normally, such wagers are divisible by 3 or 6. For example, a 48-cent box bet on number 123 is the equivalent of an 8-cent bet of the numbers 123, 132, 213, 231, 321, and 312.
5. **Call sheets.** A list of writers or ribbons, the time or times they are to be called for their lottery, and their telephone numbers or numbers.
6. **Combination bet.** A six-way number or a box number. Sometimes it is a three-way number. Different terms are used in various localities.
7. **Cut number.** A number on which the payout rate is reduced. Cut numbers can be used to discourage betting on a number or series of numbers.
8. **High money.** Gross wagers prior to being reduced by a given commission.
9. **Highs.** A list of numbers on which wagers exceeding X dollars have been accepted.
10. **Hit.** A wager placed on the winning number.
11. **Layoff.** A bet placed by one lottery bank to another lottery bank to reduce the risk of substantial loss should a number on which a bank has a substantial number of betting hit. For example, lottery A has a total of \$100 on number 601. At a payout rate of 400 to 1, if 601 was the winning lottery number, payouts on that number would total \$40,000. A lottery, especially a smaller lottery, may not wish to carry this potential loss and may place a bet itself with another lottery. For example, a \$50 layoff would reduce the potential payout to \$20,000.
12. **Low money.** Gross wagers after being reduced by a given commission. For example, a writer receives \$100 in gross wagers and is to receive a \$25 commission. High money would be \$100 and low money would be \$75.
13. **Numbers lottery bet.** A wager placed on a series of numbers, usually two- or three-digit numbers, the winning number of which is determined by a relatively random set of events.
14. **Office or telephone relay station.** A location from which a person accumulates such items as wagers, hits, outstanding balances due from or to the writers, and other financial records of a lottery.
15. **Overlook.** A bet placed on a winning on a prior lottery day that was overlooked; i.e., the lottery operation had to go back to records for the prior lottery day to ascertain if the bettor had placed a bet on the winning number and it failed to pay.
16. **Ribbon.** A person who supervises or receives wagers from writers and forwards such wagers. A ribbon may also be a writer. A ribbon can also be adding machine tape.
17. **Six-way number.** Any three-digit number from 000 to 999 in which none of the numbers are the same. There are six permutations of these numbers. For example, the numbers 1, 2, and 3 can be arranged as 123, 132, 231, 213, 321, and 312.
18. **Stocks and bonds lottery.** A three-digit lottery in which the winning number is determined from the published results of trading on the New York Stock Exchange. Wagers can be placed on any one of 1,000 numbers from 000 to 999. The first two digits of the winning number are determined from the \$1000,000 and \$10,000 digits of the total bond sales on a given day, and the third digit is determined from the 10,000 digit of units traded on the New York Stock Exchange.

19. **Straight or triple number.** Any three-digit number from 000 to 999 in which all three digits are the same.
20. **Three-way number.** Any three-digit number from 000 to 999 in which two of the three digits are the same. There are three permutations of these numbers. For example, the numbers 1, 1, and 2 can be arranged 112, 121, and 211.
21. **Two-digit lottery.** Any lottery on which wagers on two-digit numbers 00 to 99 are accepted. The winning number may be derived from any one of several random sources. For example, the winning number for the “Wednesday, Puerto Rico” is published in the *Pittsburgh Courier*. “The Saturday Dog” is determined from the results of pari-mutuel payoffs on certain races at a given dog track. The “Sunday Nighthouse” is determined by a drawing from a bag containing 100 numbered bolita balls, etc.
22. **Wall number.** A wager on a lottery number that is to be repeated for an extended period. For example, on a week wall bet, the wager would be repeated each day of a given week. A wall bet may be placed for 2 days or may extend through an indefinite period. This term varies by locality. For example, in the Mid-Atlantic region, it is referred to as “keep in.”

### 16.3.2 Lottery Operations

The following organizational chart shows the structure of a lottery organization:



**Figure 16.1** Lottery organization chart.

1. **Banker.** The person who directs, finances, controls, and receives the final profit. In many cases, the banker does not participate in the day-to-day operations. He relies on his office manager to handle them. The banker usually receives 10% of the gross receipts as his profits from the operations. If the banker does not have an office manager, then he will participate actively in the day-to-day operations. In this case, the banker’s commission will be 20 to 30%.
2. **Office manager.** Accumulates the wagers, hits, outstanding balances due from or to the writers, and other financial records of the lottery. He provides the cutoff time for writers to call in their final bets. This prevents writers from including winning numbers in the tally. The office manager will have collectors who collect



from ribbons and writers and make payouts. The office manager directs and controls the collectors.

3. **Writer.** Takes the bets and money from the bettors. He reports to the office manager regarding the total bets placed and funds collected. The writer pays the collector the money owed to the banker, less his commission. If the writer has to pay a winning number and does not have the funds to do so, then the collector will provide the funds from the office manager. Writers in large operations are known as ribbons. The writers usually earn a commission of 25%. In large operations, the ribbon may have writers under them, to which they pay a commission of usually 5 to 7%.

### 16.3.3 Lottery Examples

The following examples illustrate both two-digit and three-digit lotteries. An explanation follows the illustration.

#### 16.3.3.1 Two-Digit Lottery

The following is an illustration of a two-digit lottery that a ribbon/writer has taken from his bettors:

Bettor	Number	Bet
Bill	12	\$1
Chuck	78/	1
Dan	44	1
198	67	1
134	23/	1*

Bill placed a wager of \$1 on the number 12. Chuck placed a bet of \$1 on 78. This is a box bet since Chuck wants numbers 78 and 87. Dan placed a bet of \$1 on 44. This is a straight number since both digits are the same. Bettor 198 placed a straight bet on 67 for \$1. The bettor is not identified by name, but by a number assigned to him. Bettor 134 placed a box bet on number 23 for \$1. The box numbers are 23 and 32. Bettor 134 is a winner and will receive \$30 to \$40 on a \$1 bet. If this was not a box bet, then the bettor would receive \$40 to \$60. The writer will usually circle the number that is the winner on his tally sheet and trace the number back to his bettor's sheet.

The writer will summarize his bets for the ribbon or office manager as illustrated below:

Number	Bets
00	\$130
01	450
02	300
03	180
04	250
//	//
23*	210
//	//
98	100
99	50
Total	18,500

In this case, the winning number is 23 (and 32 for box bets). The total amount of wagers placed on this number is \$210. The writer collected a total of \$18,500 from all bettors. If the payout is \$30 and \$40 to one, then the writer would have the following accounting:

Gross bettor income	\$18,500
Payouts:	
110 @ \$30	3,300
200 @ \$40	8,000
Commission earned (25%)	4,625
Net due officer manager	2,575

The 110 @ \$30 is for box bettors, while 200 @ \$40 is for straight bettors. It should be noted that some two-digit lottery operations do not allow box bets.

**16.3.3.2 Three-Digit Lottery**

The following illustration shows how a three-digit lottery operates at the ribbon/writer level.

Bettor	Number	Bet
Bill	235	\$1
Chuck	111	1
148/	121	1
160/	365	1

Bill placed a straight bet on the number 235 for \$1. Chuck placed a bet of \$1 on 111, which is a triple number where all three digits are the same. Bettor 148 placed a box bet on number 121 for \$1. This is a three-way number since two of the three digits are the same. In a box bet, the bettor would win on numbers 121, 112, and 211. Bettor 160 placed a box bet on number 365 for \$1. This is a six-way number. There are six permutations of this number: 365, 635, 563, 356, 536, and 653.

The ribbon/writer would summarize his bets for the office manager as follows:

Number	Bets
111	230
121	120
235/*	210
300	200
310/	280
365	180
465	312
535	295
678	286
//	//
879/	195
978	233
Total	98,000

The winning number is 235. Bettors who made straight or box bets would win on this number. If the bettor placed a box bet on 235, 253, 532, 523, 325, or 352, he would win. The bettor who made a straight bet (235) would win \$400 to \$1, while those who bet on a box would normally win \$300 to \$1. The box bets are called cut numbers since they pay out less than a straight bet.

The ribbon/writer would account for his business activity as follows:

Gross bets collected	\$98,000
<hr/>	
Payouts:	
\$400 @ 90	36,000
\$300 @ 120	36,000
Commission (20%)	19,600
Net due office manager	6,400

In this scenario, the writer/ribbon collected \$98,000 in gross bets. The writer had to pay out \$36,000 to straight bettors, those who bet three- or six-way numbers. The payout to box bettors was \$36,000. The writer/ribbon gets a 20% commission of \$19,600. The balance of \$6,400 goes to the officer manager or banker.

The ribbon/writer can estimate his average payouts as follows:

$$\frac{(\$400 \times \text{no. of winners}) + (\$300 \times \text{no. of winners})}{1,000} = \text{average payout}$$

or

$$\frac{(\$400 \times 90) + (\$300 \times 120)}{1,000} = \frac{(36,000) + (36,000)}{1,000}$$

or

$$\frac{(72,000)}{1000} = 720 \text{ to } 1$$

## 16.4 Bingo

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Bingo is a game of chance where the bettor matches random numbers between 0 and 75 in groups of 15 on a randomly selected card, forming a straight line that is either vertical, horizontal, or diagonal. The bingo card has 5 random numbers going 5 across and 5 down the card, totaling 25 numbers. Usually, the center box has no number, but is called a free space. The word *Bingo* denotes the group of numbers 0 through 75 as follows:

Letter	Numbers
B	0–15
I	16–30
N	31–45
G	46–60
O	61–75

When the randomly selected numbers form a straight line, whether vertical, horizontal, or diagonal, the winner calls out “bingo.” The winner receives funds of either a fixed amount or a percentage of the gross receipts that are received by the house. An example of a winning bingo card is shown in Figure 16.2. The house calls the numbers that are winners for one player: 6, 18, 50, and 71. The center box has no number and is considered a free space (FS).

B	I	N	G	O
1	19	40	49	<b>71</b>
4	22	31	<b>50</b>	73
12	17	<b>FS</b>	53	69
10	<b>18</b>	42	47	66
<b>6</b>	29	39	58	75

**Figure 16.2** Winning bingo card.

### 16.4.1 Tax Exempt

Many nonprofit organizations hold bingo games in order to raise funds. Neither the federal nor state government taxes these profits. Legitimate charities use the profits for their needs. However, organized crime and other criminal groups use bingo halls for personal profit. Many states allow bingo halls and parlors for charity. However, it is unlawful to operate bingo halls for personal profit. Criminal groups sometimes get around this loophole by giving charities funds ranging from \$200 and up per week. The profits are skimmed from the operations after expenses have been paid.

### 16.4.2 Variations

There are three basic variations of playing bingo games: paper, grind, and lightning. Besides the normal way of getting numbers in a straight row, players must get numbers that form various patterns, i.e., X, H, O, 8, 7, E, F, etc., or black out or cover all, in which every block must be covered. Also, there are bingo games that have highlighted numbers that must be called before the player wins. There usually is no pattern for the highlighted or predetermined numbers.

#### 16.4.2.1 Paper Bingo

In paper bingo, bingo cards are printed on disposable paper. They come in various sizes. One bingo card can be printed on a small sheet, or multiple bingo cards, called faces, on a single sheet. Multiple sheets are often put together to form a package that is sold to customers so that they can play multiple games. Players also purchase ink dabbers for use in playing bingo games. These are used to mark called numbers on the bingo faces. The players throw away the sheets after a winner has been called and use another sheet for the next game. In most cases, more than one game can be played on a single sheet. Bingo halls purchase these sheets from suppliers who produce them in various sizes. The suppliers have a standard method of billing and identifying the bingo supplies. As an example, a bingo hall receives the following bill for bingo supplies (this example shows that a bingo hall purchased seven different products, whose meanings are explained below):

Description	Quantity	Total Costs
3 on V padded (1–9000), olive	1 case	\$11.50
3 on V padded (9001–18000), purple	2 cases	36.00
6 on 5 up (1–9000) BN,GY,BK,PL,RD	1 set	84.15
12 on 5 up (1–9000) BN,GY,BK,PL,RD	5 sets	420.75
12 on 10 up (9001–18000)	1 set	153.00
SBL,SOR,SGN,SYW,SPK,BL,OR,GN,YW,PK		
15 on 20 up (6001–9000) double	5 sets	292.00
SBL,SOR,SGN,SYW,SPK,BL,OR,GN,YW,PK		
18 on 20 up (18001–27000)	2 sets	306.00
SBL,SOR,SGN,SYW,SPK,BL,OR,GN,YW,PK		

**Figure 16.3** Sample bingo paper invoice.

1. **3 on V padded.** There are three faces on a single sheet. V means vertical. The faces are arranged from top to bottom. Padded means that they are all single sheets. The 1–9000 says that there are 9000 faces in a case. The sheets are all olive in color.
2. **3 on V padded.** There are three vertical faces on a single sheet. The 9–18000 means that there are 9000 faces in a case, with a series ranging from 9001 to 18000. The color is purple.
3. **6 on 5 up.** There are six faces on a sheet, with three down and two across. The 5 up means that there are five sheets in the set. A player can play five bingo games. The series ranges from 1 to 9000. Each sheet in the set has a different color. This allows bingo operators to make each player use the same color.
4. **12 on 5 up.** There are 12 faces on a sheet, with 3 down and 4 across. The 5 up means that there are five sheets in the set with different colors.
5. **12 on 10 up.** There are 12 faces on a sheet, with 3 down and 4 across. The 10 up means that there are 10 sheets in the set with different colors.
6. **15 on 20 up.** There are 15 faces on a sheet, with 3 down and 5 across. The 20 up means that there are 20 sheets in the set with different colors.
7. **18 on 20 up.** This set has 18 faces on a sheet, with 3 down and 6 across. The 20 up means that there are 20 sheets in the set with different colors.

Bingo operators and suppliers use the following guide to determine the number of faces per set and booklet, and the number of booklets in an order:

$$\text{Faces} = \text{Up} \times \text{series}$$

$$\text{Booklets} = \text{Series} \div \text{on}$$

$$\text{Faces per book} = \text{Ups} \times \text{on}$$

#### 16.4.2.1.1 Terms.

Bingo operators and suppliers define the following terms:

1. **Series.** Indicates the number of faces contained in a single set. This is usually 9000, but in large sets, it is 3000. The total series is 1 to 63,000.
2. **Face.** The individual bingo card containing 24 numbers plus a consecutively numbered center free space.
3. **On.** The number of bingo faces per sheet.

4. **Cut.** The direction a sheet of faces will be cut from a master sheet. A cut may be square, horizontal, or vertical.
5. **Up.** The number of sheets in a booklet.

**16.4.2.1.2 Off-Cut.** In off-cut bingo, faces cannot be cut from the master sheet in the desired “on.” If the master sheet is a 24 on vertical and the order is a 9 on sheet, the result will be two 9 on cuts that equal 18 faces and an off-cut of 6 faces, which totals 24 faces from the 24 on vertical sheet.

**16.4.2.1.3 Bingo Paper Sales.** Bingo halls that sell paper usually do so in various size packages. The prices of each package vary according to size. The package sizes can be composed of only one bingo product or a combination of bingo products. For internal control or fraud examination, the gross sales can be determined by use of the gross profit method of determining income. This can be done by computing the number of bingo products sold times the sales price. This will give the amount of the gross proceeds that were collected. The gross profit can be determined by taking the gross proceeds and subtracting the direct costs. The direct costs are the costs of the bingo products and the prize money paid out. To illustrate the computation of gross income, the following example is given.

A bingo hall sells the following packs to customers:

		Cost	Price
A	3 on V 2 on 10 up	\$20	\$50
B	6 on 2 up 12 on 10 up	35	75
C	3 on V 2 up 15 on 10 up	50	100

The 12 on 10 up is the common product for packs A and B. It has a series of 1 to 9000. The number of booklets in a series is  $9000/10 = 900$  booklets. The 15 on 10 up is the main product for pack C. It has a series of 1 to 9000. The number of booklets in this series is  $9000/10 = 900$  booklets.

Inventory shows that 100 booklets of 12 on 10 up and 20 booklets of 15 on 10 up were sold. The gross receipts are computed as shown below.

12 on 10 up ( $\$20 + \$35 = \$55/2 = 27.50 \times 100$ )	<u>\$2,750</u>
15 on 10 up ( $\$50 \times 20$ )	1,000
Total sales	<u>3,750</u>

The 3 on V and 6 on 2 up are excluded from the computation since they are part of the packages sold. However, the costs of these products should be part of the cost of sales.

**16.4.2.1.4 Prize Payouts.** The principal cost of sales is the prize money that is paid out. Using the above example, the cost of sales is computed as follows:

Prize ( $\$50 + \$75 + \$100 = \$225/3$ )	\$75
The number of games in the session	$\times 12$
Total prize payouts	900

The cost of the paper sold is computed on a prorated basis:

12 on 10 up ( $100/900 \times \$153$ )	\$17
15 on 10 up ( $20/900 \times \$180$ )	4
Cost of packages sold	21

It should be observed that the 3 on V and the 6 on 2 up should be added to the computation above. It is omitted in this case since the amount sold and on hand are not given.

The gross profit from this bingo hall session is computed as follows:

Gross proceeds from sales	\$3,250
Prize payouts	900
Cost of paper bingo sheets	21
Total cost of sales	921
Gross profit	2,329

### 16.4.2.2 *Grind Bingo*

Grind bingo uses reusable bingo cards. Grind bingo games are usually played faster than paper bingo. Grind bingo has one or more color cards. The card colors determine both the price for the cards and the prize payouts. For example:

- Blue cards — Cost 50 cents each, but pay out \$10
- Brown cards — Cost 75 cents each, but pay out \$20
- Red cards — Cost \$1 each, but pay out \$25
- Gold cards — Cost \$2 each, but pay out \$200

The player obtains a bag of chips. When a number is called, the player puts a chip on that number. When “bingo” is called, the winner receives the prize money for that game based on the type of card the player received. The player places money in front for the operator to collect before the game begins. The money placed in front is dependent on the color and number of cards the player is using, e.g., 50 cents for blue cards, 75 cents for brown cards, etc.

**16.4.2.2.1 Grind Bingo Income.** Grind bingo income is determined simply by multiplying the average number of players by the average number of games per day by the average income per game. The key elements in determining gross income are knowing:

1. The average number of players during each session.
2. The number of games played during the session. This usually averages 20 to 26 games per hour.
3. The amount of funds collected from the floor based on the average type (colors) of cards being played.

This type of bingo is more labor intensive since it requires each set of tables to have a floor person collect the coins. However, the floor person has to turn in a tally sheet and the coins to the manager after each game or session. This type of bingo is often called 10-cent bingo. Grind bingo callers must call the letter and the number, i.e., B-5, I-20, N-33, etc. These types of bingo halls are generally found in lower-income neighborhoods since

the costs seem low to play. In actuality, though, it costs the players almost the same as paper bingo.

### 16.4.2.3 *Lightning Bingo*

Lightning bingo is about the same as grind bingo, except that it uses cards that have some highlighted numbers. Players use reusable cards and play with coins. The players must get the highlighted numbers to win. The caller does not call out the letters, but only the numbers. It is called lightning bingo because the games only last about 10 to 15 seconds each. Gross proceeds for lightning bingo are computed the same way as for grind bingo. In many states, this form of bingo is illegal since it does not call out letters and is classified as a numbers racket.

## 16.5 **Pari-Mutuel Wagering**

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Pari-mutuel wagering is gambling at various types of racetracks or sporting events. The racetracks usually involve dog, car, and horse races. Jai alai is the most common sport for pari-mutuel wagering. Many states have legalized pari-mutuel wagering on either racing or sporting events, or both. Like other types of gambling activities, pari-mutuel wagering has its own terminology. Pari-mutuel means each player is competing against another, and not against the track.

### 16.5.1 **Terminology**

Understanding the terms of pari-mutuel wagering will help the examiner understand the mechanics of pari-mutuel wagering. The following are the most common terms used:

1. **Across the board.** Three equal wagers placed on one animal to win, place, and show.
2. **Boxing.** The bettor selects any number of animals (three or more) in a race. If the selections finish one, two, or three, in any order, the bettor wins. In a quinella box, if any two selections finish one or two, in any order, the bettor wins.
3. **Breakage.** The difference between true mutuel odds and lesser, rounded amounts given to winning players. Breakage usually is divided between track and state.
4. **Chalk.** A term that refers to the favorite in a race.
5. **Closing odds.** The odds displayed on the tote board after wagering closes.
6. **Coupled.** Two or more animals, belonging to the same owner.
7. **Daily double.** A wager whereby the bettor must select the winners of two consecutive races, usually the first and second races, prior to the first race.
8. **Daily triple.** A wager whereby the bettor must select the winners of three consecutive races.
9. **Entry.** Two or more animals in a race, owned by the same person(s) or trained by the same trainer, are termed an entry and coupled as a single betting unit; a bet on one coupled horse is a bet on all horses it is coupled with.
10. **Exacta.** A wager that a bettor wins when he selects the first and second place finishers in a race in exact order.
11. **Field.** An animal grouped with other animals as a single betting interest in races where the number of starters exceeds the number of betting interests the track's



tote system can handle; a bet on one field animal is a bet on all animals in the mutuel field.

12. **Handicapping.** Studying race histories to select the best wagering options.
13. **Handle.** The total amount wagered on a race or on a day's races.
14. **Hedging.** The art of covering the original bet by placing an additional wager to cover the potential loss of the first. An example would be buying a \$2 place or show ticket to ensure a \$2 win bet.
15. **In the money.** Finishing first, second, or third.
16. **Minus pool.** In pari-mutuel betting, a situation in which so much money is bet on an animal (usually to show) that the pool is insufficient after the take and breakage to pay holders of winning tickets the legal minimum odds of 1 to 10 or 20. The track is required to make up the difference from its own funds.
17. **Morning line.** The track handicapper's estimate of the probable odds for each animal at post time.
18. **Mutuel field.** A grouping of animals as a single betting interest in races where the number of starters exceeds the number of betting interests the track's tote system can handle; a bet on one field animal is a bet on all mutuel field animals.
19. **Odds on.** Odds that are less than even money (\$1 to \$1).
20. **Off the board.** Failure to finish first, second, or third (in the money).
21. **On the nose.** A bet that an animal will win.
22. **Overlay.** An underbet animal, a good value.
23. **Parlay.** A wagering format that allows each player to compete against the other players rather than against the track.
24. **Perfecta.** To win this wager, the animals must finish first and second in the exact order of finish.
25. **Pick 3.** A bettor wins when he selects the winners of three consecutive races on one ticket, which he must buy before the first of the three races begins.
26. **Pick 6.** A bettor wins when he selects the winners of six consecutive races on one ticket, which he must buy before the first of the six races begins. If no one correctly picks all six winners, half the pot will be paid to patrons correctly picking the most winners, and the other half will carry over to the pick 6 pool on the next racing day.
27. **Place.** A bettor wins when his selection finishes first or second.
28. **Pool.** The total amount of money wagered on any one type of bet (win pool, show pool, exacta pool, etc.).
29. **Quinella.** A bettor wins when he selects two animals finishing first and second in a race, regardless of order.
30. **Show.** A bettor wins when his selection finishes first, second, or third.
31. **Superfecta.** A bettor wins when his selection finishes first, second, third, and fourth in the exact order of finish.
32. **Takeout.** The percentage of betting pools taken out by the state and the racetrack, with the track putting its share of the takeout toward race purses and expenses. It also means the withholding on winning tickets over \$5,000, which is turned over to the Internal Revenue Service.
33. **Totalisator (tote).** The system of computers and electronic components tied to the pari-mutuel ticket-issuing machines that calculates the odds to \$1 and computes the various winning payoffs.

34. **Tote board.** An electronic board in the infield displaying approximate odds, amounts bet, track condition, post time, time of day, result of race, inquiry or objection sign if a foul is claimed, running time, and payoff prices.
35. **Trifecta (triple).** A wager in which the winning bettor picks the first three finishers of a race in exact order.
36. **Wheel.** To make an exotic wager (e.g., exacta or daily double) using a single key animal with the balance of the field (in the case of an exacta) or all the animals in the other race (in the case of a daily double).
37. **Win.** A bettor wins when his selection finishes first.

### 16.5.2 Odds and Payoff

The following chart is the odds on dogs or horses and the payoff to winners based on a \$2 bet.

Odds	Payoff	Odds	Payoff	Odds	Payoff
1-5	\$2.40	9-5	\$5.60	8-1	\$18.00
2-5	2.80	2-1	6.00	9-1	20.00
1-2	3.00	5-2	7.00	10-1	22.00
3-5	3.20	3-1	8.00	12-1	26.00
4-5	3.60	7-2	9.00	15-1	32.00
1-1	4.00	4-1	10.00	20-1	42.00
6-5	4.40	9-2	11.00	30-1	62.00
7-5	4.80	5-1	12.00	40-1	82.00
3-2	5.00	6-1	14.00	50-1	102.00
8-5	5.20	7-1	16.00	99-1	200.00

### 16.5.3 Ten-Percenting

Ten-percenting is illegal at the federal level and in most states. Ten-percenting is a scheme whereby the true winner of a bet sells his winning ticket to another person for a 10% fee, thus the term 10-percenting. The true winner of the winning ticket does not want the track to file a W-2G with the Internal Revenue Service. If the winning ticket pays off over \$5,000, then the track is required to withhold 28% from the winnings. A 10-percenter takes the winning ticket to the track teller. He fills out the W-2G and collects the winnings. He keeps 10% of the winning and gives the balance to the true winner. In the case of winning tickets that require income tax withholding, the 10-percenter gives the true winner the balance of the winnings after the income tax withholding and his 10% has been deducted. The Internal Revenue Service only requires W-2G forms to be filed when the winnings exceed \$1,000. The 10-percenter collects losing tickets off the track floor. He gathers enough losing tickets to offset the winnings. If there is income tax withholding, the 10-percenter files his individual income tax return to claim the winnings offset by the losses, which results in an income tax refund.

#### 16.5.3.1 Indicators

There are many indicators that show a person may be 10-percenting at the tracks:

1. A very large amount of winnings from any particular track that requires the filing of W-2G forms.

2. A very large amount of winnings from any particular track with only takeout (withholding of income tax) W-2G forms.
3. The bettor presents losing tickets that show two or more tickets with the same date and time. Some tracks use systems that do not show the times on the tickets; however, the tracks can provide data as to when the tickets were purchased.
4. The bettor presents losing tickets from different tracks that were purchased on the same date, but the time of purchase is minutes apart. The tracks are miles apart, which means that it is impossible to go from one track to the other within the time frame.
5. The bettor presents losing tickets from the same teller. The teller history for that day shows a series of tickets being purchased in sequence in which none are winning tickets. The bettor does not have all of the sequential tickets that were purchased in a series (multiple tickets purchased at once).
6. The bettor has a full-time job but presents tickets that show he was at the track all day, when in fact he was at his job.
7. The bettor provides losing tickets in such quantity that it is impossible to purchase them in any one day.
8. The bettor's losing tickets do not show any constant pattern. Bettors usually have a pattern of betting.
9. The bettor has no other sources of income but W-2G forms.
10. The bettor does not complete the W-2G correctly or falsely. Ten-percenters sometimes use false Social Security numbers, false names, or both. Sometimes they use other people's names and Social Security numbers.
11. The bettor has a lot of winnings from one track, but has large losses from another track.
12. The bettor has a criminal past of illegal gambling. Criminals that are involved in gambling activities go from one form of gambling to another when they hear or feel that law enforcement is looking into a particular type of illegal gambling.
13. A cash flow schedule of the winning and losing tickets is prepared. If the bettor does not have any other sources of funds, then any negative cash balances clearly indicate that the bettor is a 10-percenter. No one can have a negative cash amount on hand.

More than one of these indicators should be present before an examiner considers the bettor a 10-percenter. If many of these indicators are present, then the bettor is a 10-percenter. However, item 13 clearly shows that the bettor is a 10-percenter, since no one can have a negative cash on hand.

### **16.5.3.2 Violation**

For federal purposes, as well as in many states, 10-percentening is illegal. It is illegal in that taxes are not properly reported. The true winner is not paying the income taxes on his winnings, both federal and state. The 10-percenter is not paying taxes on the winnings either. The 10-percenter who signs the W-2G signs the form under penalties of perjury. This is a felony of making a false statement. The signer of the W-2G is also declaring "that no other person is entitled to any part of these payments." In essence, the 10-percenter is committing two felony counts: tax evasion and making a false statement. Each signed W-2G is a separate felony count.

## 16.6 Gambling

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Many people gamble in various ways. Some of the common methods were discussed above because they either are illegal or can be illegal, depending on circumstances. Some gamblers, as described in the movies, play various kinds of card games. Card games are basically illegal in most states if they involve betting, but because most card games are privately held, law enforcement does not get involved unless something brings them to their attention (i.e., extortion, murder, organized crime, loan-sharking, etc.). Many states now have lotteries. Those states use the profits from lotteries to help finance education, roads, and other types of services. Private lottery operations are illegal in all states. Bingo is legal in most states provided that it benefits charitable organizations. Organized crime groups get involved in illegal gambling. In some areas, they control illegal gambling operations. Anyone who tries to set up a gambling operation in an area controlled by organized crime can find himself at odds, to say the least. Illegal gambling offers organized crime groups the ability to skim huge profits.

## 16.7 Summary

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Illegal gambling is one occupation for organized crime involvement. In fact, there are individuals who get involved in illegal gambling. Individuals usually start out by taking bets with friends, eventually mushrooming into a large business venture. Criminal organizations usually set up operations when they find an area prone to such activities. The investigator needs to know how the various gaming entities operate in order to prepare a case. Police departments will get a tip of illegal gambling. When they do, they will usually start with getting an undercover officer to make bets and identify the principals. This will lead to getting wiretaps and making trash pickups. The final phase is executing search and arrest warrants. Before going to trial, the investigator will have to analyze and summarize the gambling information for trial. It is therefore important for the financial investigator to understand how the various gaming methods work.



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# Fraud Prevention for Consumers

# 17



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## 17.1 Introduction

There are many precautions that the consumer can take to prevent fraud. There is an old cliché that says “an ounce of prevention is worth a pound of cure.” This is particularly true in the area of crime. If consumers will take the appropriate steps and procedures to prevent fraud, then their losses can be nonexistent or minimal. In many cases, fraud can be prevented by making appropriate inquiries, while more investigative procedures are required in other cases. It should be stressed here that taking all precautions possible does not guarantee that consumers will not become victims; however, it will reduce the chances of becoming a victim. There are many con artists, regardless of all precautions taken, who can “take your shoes while you’re standing in them.” Therefore, the procedures and precautions taken to prevent fraud do not guarantee anyone from being a fraud victim. It is also not true that all people or businesses are in the business of committing fraud.

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## 17.2 Consumers

Consumers are vulnerable to many kinds of fraud schemes. These range from small car repairs to large investment schemes. Statistics show that the elderly, women, and minorities are victimized the most. However, in recent years, practically everyone is vulnerable to fraud schemes. Even well-educated and knowledgeable people have become victims. There are con men out there that can almost literally steal your shoes while you are standing in them. These people are very personable and friendly. The following describes the more common fraud schemes that consumers face. It should be remembered that the consumer should beware. One advertiser said an “educated consumer is our best customer”; however, it can be said that an educated consumer has the best defense against becoming a fraud victim.

### 17.3 Automobile Purchases

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There are automobile dealerships that operate in both an unethical manner and fraudulently. An auto dealer will advertise a particular vehicle for a certain price. When the consumer goes to look at this particular vehicle, the salesman says that it is out of stock. He will try to direct the consumer to another model, which usually costs more. Using high-pressure sales tactics, the salesman will get the consumer to purchase the more expensive car. This is true for both new and used car dealerships. If you have decided upon a particular vehicle that you want, then you should make inquiries as to when this model will become available. If the model will not become available anytime soon, then you should walk out and ignore any salesman's "deals." In the case of a used car dealership, you should ask the salesman if a mechanic of your own choosing could inspect and test the car. If the salesman denies your request, then you should not waste your time in looking at the car. Most likely, the vehicle is a lemon. If the salesman approves your request, then retain a mechanic that will check the vehicle out, and follow his advice regarding whether you should purchase it. If you are going to finance the vehicle, it is recommended that you arrange for your own financing in advance. Most finance companies, banks, etc., will approve vehicle loans up to certain dollar amounts. The car dealerships have made arrangements with particular finance companies in which they will get a rebate. These financing arrangements will charge higher interest rates on the vehicle loans so that they can cover these rebates. These arrangements are not illegal.

### 17.4 Business Investment

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Many people are losing their jobs because of economic conditions, downsizing of companies, and a whole host of other reasons. Many people are looking to acquire or start up their own business. The problem of starting up your own business is having the necessary capital and knowledge to do so. Many investors will turn to a business broker who can offer a wide range of existing businesses that are for sale. The broker may be legitimate, but the prospective business may not be. Business owners will try to inflate the books to show higher sales and profits in order to entice someone to buy when, in fact, the business is operating at a loss. Some owners will go so far as to say that they are taking out funds not recorded on the books. They will even brag about it. This is an indication of fraud, both to federal and state tax collectors and to the prospective buyer. An established business is a better investment than starting from scratch; however, an established business could be a worse investment than starting from scratch. This is particularly true if the buyer does not know what to look out for or how to evaluate the prospective business. The following guidelines are provided.

1. **Financial statements.** The prospective buyer should obtain financial statements for not only the current year, but also the past 4 years as a minimum. In addition, tax returns should be obtained for the last 3 years. These financial statements and tax returns should be analyzed to see the trends and conditions of the business. Questions the prospective buyer should ask are: Are sales increasing each year? Are assets remaining steady or increasing? Is inventory increasing with sales? Further auditing procedures are explained in Chapter 23. If the buyer does not know how

to analyze and audit the statements, then an accountant should be retained to do so. His fees will cost much less than the possible loss the buyer could have in acquiring a bad business.

2. **Bank statements.** The prospective buyer should obtain the bank statements for at least the past 2 years, along with the current year. The deposits should be compared to the gross receipts reported on the tax returns and the financial statements. Explanations should be sought out for any large differences, especially when inventory, liabilities, and assets do not increase.
3. **Observation.** The prospective buyer should visit the business location on various occasions. The purpose is to see what the customer traffic is in the business and if the assets and inventory exist as purported on the financial statements.
4. **Purchase price.** The seller will always ask more than the business is worth. For businesses that have been in existence many years, the owner will have a personal attachment and concern for whoever takes over. Therefore, he will want much more than what the business is worth. As a prospective buyer, you will want to acquire the business at a reasonable price. As a general guideline, the prospective buyer should acquire the business based on the following formula:
  - a. Net worth of the business.
  - b. Add to the net worth the accumulated depreciation and amortization.
  - c. Add any shareholder loans (this item shows up as an outside liability).
  - d. This gives the total equity by the owner.
  - e. Add the yearly officer salaries and bonuses.
  - f. Add the yearly profits based on the time frame in which you plan to finance part of the purchase.
  - g. This gives the purchase price that you, the prospective buyer, should pay for the business.

The profits can be considered the goodwill of the business. If the business is acquired solely for cash, then goodwill can be paid based on the net profits of the business. However, goodwill should not be paid for more than 5 years of profits. If there are no profits, then there is no goodwill.

From the seller's point of view, the business owner should not expect that he or she could get more than what the above formula shows. However, the seller will have to evaluate the buyer when he or she is going to take a note or payment plan for part of the purchase price. The seller will have to evaluate the prospective purchaser in the following ways:

1. **Payment of note.** Can the business pay off the note without any hardship on the buyer? If the formula described above is followed, then the business can pay off the note. It should be noted that the prospective buyer's only source of income would be the business.
2. **Buyer.** The buyer should be investigated if a note is part of the purchase price. The following questions should be answered:
  - a. Does the prospective buyer have any expertise in this type of business? If not, how much time will the prospective buyer require for training? Some training is required to give the prospective buyer some knowledge of the operations. He will have to know the vendors and their policies, banking relationships, em-



- ployees, regular customers, and the policies and procedures the business has been following.
- b. What is the character and integrity of the prospective buyer? References should be checked out. County records should be checked for any criminal or civil actions. You should be aware of references with answering machines. Also, previous employers should be contacted regarding job performance and character.
  - c. What is the credit rating of the prospective buyer? A credit report should be obtained from the credit bureau. It will show promptly the prospective buyer's record of paying off debts. If the prospective buyer has a record of delinquent payments, then you can expect the same.

## 17.5 Accountants

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Many people go to accountants for various purposes. Among those purposes are tax return preparation, accounting advice and services, management advice, and business audits. However, there are some accountants that are unscrupulous. In tax return preparation, they will decrease income, increase deductions, or both. The taxpayer gets a large refund. When the Internal Revenue Service or other taxing authority audits the taxpayer, he will have to repay the shortage along with penalties and interest. The penalties and interest can double or even triple the original tax liability. Only certified public accountants (CPAs) and enrolled agents (EAs) are allowed to represent taxpayers before the Internal Revenue Service and most other taxing authorities. These individuals have the appropriate training and experience. There are many individuals and companies that prepare tax returns that are not qualified to represent taxpayers. There are some national chains that have offices across the country. Some of these national chains offer 6-week courses to train their tax preparers. When these tax preparers complete the course, they think they have become tax experts. This is ironic because it takes nearly 6 months to train revenue agents in the federal tax code and regulations. The major problem with nonlicensed accountants is that they become negligent due to incompetence, while licensed tax preparers, who have the appropriate training and education, prepare fraudulent tax returns to obtain higher fees. The taxpayer thinks the accountant is very good since he is getting a refund larger than usual. The taxpayer should consider the following factors when having his tax returns completed:

1. **Fees.** The charges for services should be known before engaging the accountant. Fees are charged either by the number of forms to be completed or by the time required to complete the returns.
2. **License.** If the taxpayer has a complex return, then a CPA or enrolled agent should be retained since they have the training and experience. Also, they can represent the taxpayer in an audit. Higher-income and complex tax returns tend to be audited more than simple returns.
3. **Check return.** The taxpayer should review his return before signing and sending it off. Remember, the taxpayer provided the information to the preparer; therefore, the taxpayer should compare the information provided to the information on the return to see if they match. The taxpayer should keep in mind that he or she is responsible for the accuracy of the return, not the accountant.

People who have their own business retain an accountant for various services, principally various federal and state tax return preparations, periodic financial statements, and management advice. The greater use of the services leads to greater contact, reliance, and trust of the accountant. However, the accountant may be a crook. There are many cases where the accountant has absconded with clients' funds. The following precautions should be followed to prevent this:

1. The accountant should never be a signatory on any bank account.
2. All tax returns should be signed and mailed in by the taxpayer and not by the accountant.
3. The accountant should not have any custodial control over any personal or business assets.
4. Investments proposed by the accountant should be reviewed by someone else, i.e., a certified financial planner. Accountants are trained to evaluate past performance, not future expectations. Financial planners are trained to evaluate investments regarding future returns.
5. The accountant should not be retained as a trustee for any estate or trust. However, the accountant should be used to prepare the tax returns and financial statements for these. This serves as a way to oversee the affairs of a trustee.

## 17.6 Attorneys

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Fraud that is committed by attorneys usually falls into two areas: (1) overcharging the client for his services and (2) a violation of trust where the attorney outright steals from the client. Some unscrupulous attorneys, in conjunction with doctors, operate an "ambulance chasing" scam. In personal injury cases, lawyers are paid on contingency fees. This means the lawyer and the client agree that the fee will be based on a percentage of the settlement or court award in the case. If no settlement or court award is made, the lawyer will not be paid. This type of law practice requires a high volume of cases to ensure a steady cash flow. Lawyers running personal injury mills are not anxious to engage in litigation. They rely on the insurance company's desire to settle quickly, realizing the expense a company must absorb by going to court to fight a claim. The lawyer will entice accident victims to cooperate by promising a big payday from the insurance company. The big payday often never arrives for the victim, since medical, runner, and contingency fees may be deducted before the victim gets his or her share. Some ambulance-chasing lawyers blatantly rip off their clients by forging the signature of the victim on the insurance company check. Even if the victims discover their lawyers cheated them, they are reluctant to report fraud, since they too conspired to defraud the insurance company. The consumer, therefore, should take the following measures in dealing with personal injury cases:

1. Consult his or her own doctor regarding the extent of the injuries before consulting a lawyer.
2. Obtain a complete statement regarding all the charges and evaluate their reasonableness.
3. Discuss and obtain a copy of the engagement contract from the attorney.

4. Use his own doctor instead of one the lawyer recommends. It is almost certain that the lawyer-recommended doctor's fees would be above those normally charged by others.
5. Make inquiry to their local or state consumer affairs department regarding any complaints or disciplinary actions against the lawyer. County public records should be searched for any lawsuits against the lawyer. A large number of complaints or lawsuits is an indication of an unscrupulous attorney.
6. Ambulance-chasing lawyers use people called runners to obtain business. The runners will approach victims soon after the accident, sometimes while at the scene. They will give a lawyer's business card and urge the victim to call a certain attorney. They also promise big paydays. This is a clear sign of an attorney that the consumer will want to avoid.

The second area of fraudulent lawyers is the positions of trust. The client is relying on the attorney to handle certain financial matters. The attorney, in handling these financial matters, embezzles the funds of the client. This happens a lot in areas of real estate sales, probating an estate, and performing trustee duties. This can be very blatant or very clandestine. Few attorneys actually take their clients' funds and flee; however, many attorneys will pad expenses, overcharge fees, and inflate bills. The client should review these expenses before taking the final settlement.

## 17.7 Bankers

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Bankers can be thieves in various ways. First, they can embezzle funds from the bank using various schemes. Second, they can overcharge for their services. One way to steal from customers is to provide encoded deposit slips for their own account instead of the customer's account. Many banks have tried to prevent this by not having deposit slips displayed in the lobby. However, some customers will not have any deposit slips and will ask for them from their banker. The banker then gives them some with an encoded account number not belonging to the customer. The customer makes a deposit, but the funds go to the banker. When a customer makes a deposit using counter deposit slips, she should check the encoded number on the bottom to see if it matches the account number on her checks.

Bankers also overcharge for obtaining a bank loan. In the case of car and boat loans, they will inflate the expenses of obtaining an appraisal for the used car or boat. In recent years, this has been a common practice in granting home equity loans. Also, bankers charge high rates of interest or large points for customers obtaining home equity loans. Points are bank fees for processing loan applications, principally real estate loans. Customers should be aware of points over 4%. Home mortgages should not be more than 3 points over the prime rate. The prime rate is what banks charge their preferred customers. This is published daily in most newspapers across the country.

With the advent of automatic teller machines (ATMs), unscrupulous bankers have been able to embezzle funds from customer accounts. Bankers can get personal identification numbers (PINs) if the bank's internal controls are deficient. Also, they can obtain duplicate cards, allegedly by customer request. With duplicate ATM cards and PINs, a banker can access the customer's account and withdraw funds. To prevent this, the cus-

tomers should review and reconcile his bank statements every month; otherwise, these withdrawals by the banker will go undetected for some time.

## 17.8 Credit Cards

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With the widespread use of credit cards, credit card fraud has become an easy source of income for criminals. Some bank credit cards, e.g., VISA and MasterCard, can be used at ATMs for cash withdrawals. However, most credit card thieves will not have access to PINs. Credit card thieves are usually organized and have more than one person involved. Some credit cards are stolen from the mail before customers can receive them. Other thieves obtain the credit card or the numbers from where the customer has made a purchase. Thieves use the customer's number or credit card to make additional purchases. The goods purchased are fenced to a store or through a store that they control, or are hooked at a pawnshop. Some business establishments will make additional charges on customer's credit cards for services or purchases not rendered. The counterfeiting of credit cards is becoming more prevalent. For the credit card holder, the following precautions should be followed:

1. If you apply for a credit card, the credit card company will notify you of approval and approximately when the credit card will be sent. If you do not receive the credit card in the time frame specified, you should make inquiries about it.
2. When making purchases, always obtain a copy of the charge slip and any carbon paper used. Never rely on the business establishment to destroy the carbon paper. The carbon paper shows your account number and expiration date, which can be used to make purchases. The use of carbon charge slips is becoming extinct and will be eliminated eventually.
3. When making purchases, ensure that your credit card is returned to you.
4. Always review your statements as to the charges made, and ask yourself, "Did I make this charge?" If you are not sure, make inquiries to the credit card company. You should save your card receipts and compare them with your billing statements. Report promptly and in writing any questionable charges to the card issuer.
5. Notify the credit card company if you get a statement for a credit card that you do not have. Also, it is advisable to notify your local police about this.
6. Never pay a fee when applying for a credit card. There are "boiler room" operators who advertise that they can obtain a credit card for you even if you have bad or no credit. For them to get this credit card, they require that the applicant submit an application and a processing fee of anywhere from \$100 and up. In some states, this processing fee is illegal. The applicant will not get a credit card and will be out the fee.
7. Sign your new cards as soon as they arrive.
8. Carry your cards separately from your wallet. Also, keep a record of your card numbers, their expiration dates, and the phone number and address of each company in a secure place.
9. Avoid signing a blank receipt whenever possible. Draw a line through blank spaces above the total when you sign card receipts.
10. Obtain and destroy all carbons and incorrect receipts.
11. Notify card companies in advance of a change of address.

12. Never lend your card to anyone.
13. Never leave cards or receipts lying around.
14. Never put your card number on a postcard or on the outside of an envelope.
15. Never give your number over the phone or the Internet unless you are initiating a transaction with a company you know is reputable. If you have questions about the company, then check with your local consumer protection office or the Better Business Bureau before ordering.

## 17.9 Boat Purchases

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Boat dealers operate in the same manner as automobile dealers. The rules that apply for automobiles, explained earlier, also apply for boat dealers. For large used boats, banks require a hull appraisal and certification by an appraiser. The prospective buyer should make various inquiries with appraisers as to area fees for such hull certifications. In some cases, the banks inflate the appraiser's fee.

## 17.10 Contractors

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Many people want to either build their dream house or remodel their current house. This involves building a house from the ground up or adding space to a room, reroofing, installing new windows and doors, or remodeling a room. Many people will buy new homes that were built by a land developer in a planned community. The contractors who commit fraud do so by either overcharging or using inferior materials, usually both. Consumers usually will call a contractor listed in the yellow pages of the telephone directory or may be solicited over the telephone. Telephone solicitors are more prone to being scam artists. Also, their prices are usually much higher. Land developers will build a model for customers to inspect before their house is built. The model will usually be built to local building codes and with high-grade material; however, the customers' houses will be built using inferior materials and poor workmanship. There are warning signs that the consumer should be aware of in order to prevent being a victim:

1. **Advertisements.** The consumer should check listings in the telephone directory and obtain business cards and contract proposals. Many states require a contractor license number on all advertisements.
2. **Down payment.** The consumer should never make a large down payment. Down payments should never be more than 25% of the total contract price. If the contract is being financed, the down payment should never be more than what the finance company or bank requires.
3. **Partial payment.** In case of large jobs or building a whole house, partial payments should equal the amount of costs incurred by the contractor.
4. **Permits.** The contractor should always get the permits required. No one else should get permits. If the consumer obtains the permits, then it leaves the consumer liable for anything that goes wrong, including an injury to an employee. Small jobs do not always require a permit, but you should contact your local building department for specific requirements. The contractor should post the permit before starting

- the job; in fact, most states require building permits to be posted before the job is started.
5. **Proposal and contract.** The consumer should always get a proposal and contract in writing. No written agreement means no legal recourse.
  6. **Insurance.** The contractor in most states is required to have insurance. Consumers should obtain a copy of their insurance binder before the work begins.
  7. **Payments.** The consumer should always pay by check and not cash. The check should always be payable to the company and not the individual.
  8. **Licenses.** The contractor should have both an occupational and a state contractor's license.
  9. **References.** The contractor should be willing to provide references as to his reputation, abilities, experience, and knowledge. Consumers should see previous work done and ask previous customers about their likes and dislikes.
  10. **License boards.** The consumer should call the state licensing boards to see if the contractor is actually licensed. There are some unlicensed contractors who use other contractors' license numbers.
  11. **Bird-dogging.** In the case of large remodeling jobs or house construction, the consumer should retain a person who knows the construction industry and will act as an inspector during the course of the construction. The "inspector" should report only to the consumer.
  12. **Bids.** The consumer should always get three bids for any contracting job. He should be sure that the contractors are bidding for the same job for comparison purposes. A bid for apples cannot be compared to a bid for oranges. Also, the consumer should never pay for a bid.
  13. **Identification.** The consumer should ask for and get identification of the contractor or principals of the company. This should be done at the time of signing the contract. This will be helpful to law enforcement if the contractor skips town before the job is finished.
  14. **Complaints.** The consumer should file complaints with local and state regulators and consumer affairs offices. They can act quickly in remedying the consumer's situation if notified early. Some state regulators have police powers, and thus can take appropriate action on the consumer's behalf.

## 17.11 Doctors

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There are unscrupulous doctors who commit fraud in various ways. One common way is overbilling for services to insurance companies. This is particularly true in auto, Medicare or Medicaid, and workmen's compensation claims. Another way is charging the insurance company or the individual for tests that were not performed. Still another way for doctors to commit fraud is to sell prescription drugs that are not needed by the patient.

The patient should take the following steps to help prevent overcharges:

1. Check the local physician referral service for a recommended doctor.
2. Having located a physician, check public records for any lawsuits. This should show any malpractice and financial lawsuits.
3. Ask for a fee schedule up front, before seeing the doctor.

4. Inspect his or her bill for services. If there are charges for services that the patient feels were not performed, he should make inquiries with the doctor's office.
5. When a doctor bills the insurance company for services, review the bill upon receipt and notify the insurance company of any possible overcharges. Remember, inflated or nonperformed services mean higher insurance premiums because the insurance company has to pay higher claims.

These rules apply not only to doctors, but also to dentists, chiropractors, opticians, and other health care professionals. Hospital bills should definitely be examined, since many hospitals will overcharge for services for people with health insurance to make up the losses for nonpaying patients.

Purchasing prescription drugs when there is no need puts the doctor and patient at risk of being detected by law enforcement for drug possession or drug trafficking.

## 17.12 Insurance

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Although most agents are reputable, some unscrupulous agents may pocket premiums or use high-pressure tactics to gain a large commission. Three of the more common agent schemes are:

1. **Pocketing.** In pocketing schemes, the agent issues a binder indicating that the customer is insured against specific losses but never forwards the customer's premium payments to the insurance company. The signs of an unscrupulous agent are:
  - a. The agency employs a large number of support staff and has only one licensed agent (who is frequently absent).
  - b. The insured are those who are uneducated, young, or otherwise high risk.
  - c. The agent only accepts premium payments in cash or money orders.
  - d. No policy is received or provided.
2. **Sliding.** The term *sliding* means the art of including additional coverage with those items requested by the consumer. The extra charges are hidden in the total premium. Since the consumer does not know about the extra charges, claims against that coverage are practically nonexistent, and the profits for the agent are astounding. Since many consumers do not read their insurance policies, the crime may go undetected. Coverage that is easy to slide in includes motor club memberships, accidental death and travel accident policies, which carry premiums of less than \$100 per year. The indicators of sliding are:
  - a. The breakdown of coverage provided by the agent lists coverage in addition to that requested.
  - b. Insurance applications and other forms are quickly shuffled in front of the consumer, and a signature is required on each.
  - c. The agent offers a package deal that includes accidental death, travel accident, or motor coverage.
3. **Twisting.** Twisting is nothing more than the replacement of existing policies with new ones, where the primary reason for doing so is to enrich the agent. Commissions are higher on first-year sales; therefore, the consumer will pay more in premiums for less coverage. The signs of twisting are:

- a. The agent suggests that the policy, which is less than 1 year old, be replaced with a new and “better” one.
- b. When the consumer declines replacement coverage, the agent employs high-pressure tactics.

Insurance companies, either unknown by the agent or with the agent’s cooperation, may offer policies to consumers with the intent of not providing coverage. Most states have insurance regulatory agencies, some with enforcement authority. These insurance companies usually sell their products through boiler room operations or direct mail. Their advertisement will usually show premiums below the industry average for the area. All types of insurance are affected — auto, life, health, and business. The consumer should take the following precautions:

1. Inquire with the state insurance commission as to whether the insurance company is registered or licensed. Never purchase a policy with an unlicensed insurance company.
2. Consult an insurance advisory service, i.e., Best. These advisory services evaluate the insurance company as to its product lines, premiums, and claims paying abilities. They also rate insurance companies from bad to good based on their financial conditions and stability. The consumer should check these insurance advisory services as to the company’s financial condition and compare the premium rates with those of other insurance companies. Most libraries have these advisory services, usually in their reference section, and some can be accessed online.

## **17.13 Stockbrokers**

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Unscrupulous stockbrokers perpetrate fraud by either selling worthless securities or buying and selling their clients’ securities. Stockbrokers get commission on both sales and purchases of securities. Securities consist of stocks, bonds, and mutual funds. Commodity brokers, like stockbrokers, buy and sell various kinds of commodities for their clients. They also get commission on both sales and purchases. The fraud schemes used by both stock and commodity brokers are as follows.

### **17.13.1 Clients Accounts**

Some investors will allow their stockbroker, also their commodity broker, to buy and sell securities for them. This is not a good practice for the investor to allow. This gives the broker a blank check. The broker will sell and purchase securities for the investor. Most of the time, the sales will result in losses. The broker will get a commission on both sales and purchases. The investor will finally learn that his investment has been depleted. When an investor opens up a margin account, this automatically allows the broker to liquidate his account when it falls below the margin requirements. Margin refers to the amount of funds required to be deposited with the broker. The Federal Reserve Board of Governors sets the margin requirements and changes them from time to time. The Securities and Exchange Commission is responsible for investigation and enforcement. These margin requirements are set at a percentage of the purchase price of securities. Unscrupulous brokers will sell securities or commodities to earn a commission and tell the investor that



he fell below the margin requirements. These brokers do not notify or give the investor time to meet the margin requirements. The investor should take the following preventive measures.

1. Do not allow the broker to buy and sell without consulting the investor.
2. When using margin accounts, advise the broker to contact the investor when the margin requirements have to be met.
3. Keep track of the market prices of his securities. A brokerage statement, which is provided each month, gives the market values of the investor's securities. The investor should review these brokerage statements very closely.
4. Check with the Securities and Exchange Commission as to whether the broker is licensed. Brokers must be licensed with the Securities and Exchange Commission, as well as state authorities.
5. Ask for and check out references of the broker regarding his character, integrity, and professional abilities.
6. Check public records as to any lawsuits or criminal actions against the broker.

### **17.13.2 Worthless Securities**

Unscrupulous brokers, both stock and commodities, will sell worthless or phony securities to investors. In the 1980s, there were many corporate mergers. For one corporation to buy out another corporation, the purchasing corporation had to issue bonds. These bonds came to be called junk bonds since personal or real property did not secure them. The interest rate was very high, sometimes as high as 18% or more. The issuer found that it could not pay the interest on the bonds since the profits were not high enough to cover the interest expense. The issuing corporation had to declare bankruptcy. This led to the bondholders losing their investment. Some brokers will sell securities to investors knowing that they are on the verge of bankruptcy or in bankruptcy. Some brokers will even sell false or stolen securities to investors. These are some instances of fraud by brokers. Another area of stock and commodity fraud is selling securities at artificially inflated prices, which the broker has created. This requires collusion or control between two or more investment companies. The stock or commodities are traded between cooperating members. This drives the stock value up on the over-the-counter securities market. It is then sold to the public. These securities can be either registered or nonregistered. This results in large profits for the company by boosting the value of its shares to artificially high levels. Organized crime engages in the purchase, promotion, and sale of numerous securities. These sales are made through various boiler room operations, which are controlled by these individuals. Even though stock and commodity fraud and manipulation is complex and sophisticated, there are steps the investor can take to prevent becoming a victim:

1. Never purchase securities from telephone solicitors. Invariably, these are false securities.
2. Examine registration statements, which are available to the public. Title 15 of the U.S. Code (USC) 77(f) requires registration of securities with the SEC if they are sold by mail or in interstate commerce. Sections 77(g) and (aa) prescribe the contents of registration statements.

3. Always obtain a prospectus. Law specifically prescribes the contents and timing of the prospectus. The investor should read these prospectuses and evaluate the risk of purchasing these securities.
4. Purchase bonds based on the current interest rates. Bonds showing high rates of return should be either avoided or investigated further. Further investigation should encompass the collateral of the bonds, the ability of the issuer to redeem the bonds, and the market value of the collateral, at a minimum.
5. Review the stock market quotes for the past 2 years or more for any security or commodity. The investor needs to evaluate the trend for this security or commodity. If there is an upward swing in market value during a short period, usually less than a year, then the investor should try to determine the reason. If the security or commodity did not have increased earnings or dividends, this is a danger sign of stock manipulation and it should not be purchased.
6. Find out if the issuer of the stock or bond is in bankruptcy or reorganization under the federal bankruptcy law. This can be determined by either calling another investment firm or consulting any of the investment services at a local library.
7. Consult investment advisory services, such as Standard & Poor's or Moody's, which publish information about the company or commodity. This information encompasses earnings, dividends, market values and trends, assets, net worth, and management profiles. In addition, these services have a rating system that evaluates the security or commodity from bad to good investment potential.

### 17.14 Telemarketing

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Telemarketing is a fast-growing business. Many telemarketers are legitimate; however, there are also many fraudulent ones. The scheme involves selling products or services that are not delivered. Telemarketing is referred to as a boiler room operation. It involves hiring telephone solicitors who call customers and use high-pressure sales tactics. The customer orders the product or service and makes payment in advance. Either the product or service is not provided or an inferior product or service is provided. In most cases, these products or services cost more than what is available in local stores. There are many scheme variations. One scheme is the telemarketer tells the customer that he or she won a prize, but in order to receive it, the customer must send money for shipping, handling, or taxes. The customer sends the money, but either receives an inferior product or does not receive any product. The unscrupulous telemarketer will make misrepresentations about his product or service. This is evident in such statements as “the best deal or investment ever made” or “it’s too good to be true.” When contacted by a telemarketer, the consumer should follow these guidelines:

1. If the telemarketer is pushy in using high-pressure sales tactics, hang up the telephone. The consumer should treat the telemarketer as an obscene caller.
2. Some states have passed laws requiring telemarketers to be licensed or registered. Obtain identification on the telemarketer, as well as information about the company that he represents.

3. If the deal sounds too good to be true, be assured that it is. So, if the telemarketer makes claims about his product or service that seem too good to be true, do not order it.
4. Some products or services are forbidden to be sold over the telephone in many states. It is unlawful to sell fraudulent securities using the telephone or mail. Some states have laws against certain professions soliciting customers by mail or telephone, i.e., accounting, legal, and medical.
5. Compare prices of products and services that the telemarketer is selling to those of the same products and services in the local area. In many cases, the telemarketer's products and services cost more than what the local merchants provide. Shipping and handling charges should be considered when ordering from telemarketers. These drive up the costs.
6. It is advisable to use a credit card for making a purchase. It provides the ability for the consumer to have the credit card company cancel the charge, provided that it is done within 30 days from the date of purchase. Also, U.S. postal regulations require that the company ship the goods within 30 days. However, the consumer should review his monthly credit card statements for any possible charges by the company at a later date or fraudulent use of his credit card number at another location.
7. Make inquiries with the Better Business Bureau or the state consumer affairs department about any complaints against the company.

The consumer can register with the Federal Trade Commission by either calling 1-888-382-1222 (TTY 1-866-290-4236) or by going online at [www.donotcall.gov](http://www.donotcall.gov). The FTC maintains a list of telephone numbers that telemarketers are not allowed to call. Registration is free. Registering your telephone number will stop most telemarketer calls, but not all. It will not stop those who have called you in the past or companies that have your telephone number from past business dealings. Consumers can call the above telephone numbers and file complaints against a telemarketer. Some states also field complaints concerning telemarketing phone calls.

### **17.15 Mail Order**

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Many consumers receive junk mail that solicits them to purchase goods through the mail. Consumers can see advertisements on television and in the newspapers. Most advertisements are done by legitimate businesses; however, there are unscrupulous mail-order houses. Illicit mail-order houses operate like fraudulent telemarketers, except they lack the element of direct communication. Advertisements allow the consumer to make inquiries about the product and company before placing the order. The consumer should take the following steps:

1. Compare mail-order prices of products and services with those in the local area. Shipping and handling charges should be considered, since they can drive up the total cost of the product.
2. If the product or service sounds too good to be true, do not order it.

3. Make inquiries with the Better Business Bureau or the state consumer affairs department about any complaints or the company's existence. Some states require an out-of-state company to be registered in that state before it can do business there.
4. Consult local merchants about the special ordering of products that are not generally available. In some cases, local merchants can obtain the product or service at lower costs than the consumer can by direct mail.
5. If the product is not received within 30 days, call the company and find out its status. If a satisfactory response is not obtained, notify the local U.S. Postal Inspection Office.
6. Keep in mind that some products are not allowed to be shipped through the mail. This is particularly true for dangerous or flammable products. Also, illegal products, such as illegal drugs and pornographic material, are not allowed to be mailed.

### **17.16 Identity Theft**

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It is better to prevent identity theft in the first place than to have to get it corrected. There are individuals and criminal groups who specialize in identity theft. It can cost a victim hundreds to thousands of dollars to get it corrected. Some preventive measures are:

1. Do not give out any information unless the party requesting it needs to know your personal data. Banks and credit card companies know your account number and your mother's maiden name, so if someone calls asking for these, do not give the information out.
2. When traveling, have mail held at the post office or collected by a family member or close friend.
3. When calling someone, never pass on personal financial information. Someone nearby may be listening.
4. Check your financial information regularly and look for what should be there and what should not be there. You should reconcile your bank accounts each month and review your credit card statements each month. If you fail to get a bank or credit card statement, then you should call; do not wait. Also, check for unauthorized charges or withdrawals.
5. Obtain a credit report. The credit report should list all bank and financial accounts under your name and will provide indications of whether someone has wrongfully opened or used any accounts in your name.
6. Keep or destroy records containing your personal data. Credit card receipts and bank statements or cancelled checks contain personal data, as do many other records.
7. Never throw away credit card statements, bank statements, cancelled checks, or other items containing personal data without shredding or burning them. Thieves go through trash cans and can steal your identity.
8. When you receive a request to open a credit card, shred or burn it if you do not intend to use it. Thieves can use these applications to get credit using your name.

## 17.17 Religious/Nonprofit Organizations

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There are religious cults and nonprofit organizations that exist for the purpose of committing fraud. There are many criminals who will either call on the telephone or approach a victim on the street. They ask the person to contribute to their particular cause or organization. These causes or organizations either do not exist or are only fronts. Many criminals will claim that they are tax exempt. Nonprofit organizations, except for religious organizations, must apply to the Internal Revenue Service to get a tax exemption. The consumer can call or write to the Internal Revenue Service and find out if a particular nonprofit organization is tax exempt. If it is not, then any contributions made are not tax deductible. The United Way is an organization that conducts campaigns to raise funds for various charitable organizations. Thus, the United Way can provide contributors with a list of tax-exempt organizations that need donors.

Religious organizations present a different problem. By federal statute, religious organizations (churches, synagogues, temples, etc.) are tax exempt. This is due to the Constitution, which separates church and state. There are various evangelists who prey upon people's emotions and feelings so that they will release their pocketbooks. Some religious leaders try to control members' lives. These groups become cults. The danger signs of a corrupt religious organization are as follows:

1. The leaders claim to be the only true church.
2. The leaders never accept criticism and denounce any criticism as a negative attitude.
3. The leadership attempts to control a person's life. It starts to tell the members what to wear, what or how much to give, where to work and play, and what to do or say.
4. The leader tells the member what is right and wrong. The leader's statements, actions, and attitudes are often contradictory.
5. The religious organization is mostly isolated from the rest of the outside world. Its only contact is to improve its image to outsiders and recruit new members.
6. The religious organization wants to keep its financial affairs secret. The leadership lives a high lifestyle.

## 17.18 Summary

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The consumer should observe the following rules:

1. If the deal seems too good to be true, it probably is.
2. Investigate the company and/or product being offered. The local library is an excellent source. The Internet can also be used.
3. Never purchase any product or service from anyone who solicits you, whether by telephone, Internet, mail, or in person.
4. Never give anyone control over any part of your financial affairs unless you really know the person or company.
5. Keep your checks, credit cards, and ATM cards in a safe place and separate from other things or valuables. Never give account numbers over the telephone or Internet or to solicitors unless you contacted them.
6. Review all bank, credit card, and brokerage statements for accuracy.

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# Fraud Prevention for Businesses 18



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## 18.1 Introduction

There are many precautions that businesses can take to prevent fraud. If businesses, like consumers, will take the appropriate steps and procedures to prevent fraud, then their losses can be nonexistent or minimal. In some cases, fraud can be prevented by just making appropriate inquiries. In other cases, implementing proper internal controls can help prevent fraud. It should be stressed that taking all precautions possible does not guarantee that businesses will not become victims; however, it reduces the chances of becoming a victim. There are many con artists, regardless of all the precautions taken, who can “take your shoes while you are standing in them.”

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## 18.2 Business

Businesses can be victims of fraud in three primary areas:

1. Customers
2. Employees
3. Vendors and suppliers

They should be aware of fraud that is committed by these three groups. If fraud is uncovered by any of the three groups, then prosecution should be initiated. Failure to prosecute only encourages more fraud. Large corporations and many medium and small companies do not like to prosecute since they rationalize that it could hurt their image. This is not so. Many of the consumer frauds also apply to businesses, i.e., insurance, legal and accounting, banking, construction, repairs, etc. Therefore, those preventative measures apply to businesses. Fraud issues that concern businesses are addressed here.

### 18.2.1 Customers

Shoplifting is the most common fraud committed by customers. It involves the customer walking out of the business establishment with the merchandise either open in his hands or concealed in bags, undergarments, or elsewhere. Detecting shoplifting can be done by

observing the customer in some manner. However, some customers commit fraud in other ways. The two principal methods outside of shoplifting are the refund method and the bust-out artist.

### **18.2.1.1 Refund Method**

The refund method of committing fraud is becoming more prevalent. This has been used by criminal organizations in recent years in fencing stolen property. The customer purchases merchandise on one day and returns it later, for various reasons, for a refund. The customer later brings in more merchandise using a receipt, either the same receipt or a forged one, for another refund. The second or subsequent refund claim usually involves merchandise that is stolen or purchased from another store. Organized crime groups use the refund scam to fence stolen property. If done often enough, law enforcement agencies will believe that the business establishment is owned or controlled by organized crime. In case of large chain stores, if internal controls are not implemented and followed, then this scheme can become enormous, which will result in losses. For the business to prevent such a scheme, the following precautions are recommended:

1. When making a refund, the cashier should take back the original receipt and match it up with the refund slip. This will prevent the customer from reusing the purchase slip.
2. The business should establish a policy, which is posted for both customers and cashiers to follow. This policy should not allow refunds after 30 days. No refunds should be allowed for some small consumer items, e.g., paper products, shoes, pencils, pens, flashlight batteries, cleaning agents, etc.
3. For merchandise that has serial numbers or some specific identification that requires some detailed accounting, returned merchandise should be matched with sales records to ensure that it is the same goods that were sold.
4. For refunds that are made by credit card credit slips, account numbers should be analyzed to identify customers with excessive refunds. Excessive refunds should be gauged to the number of refunds made to the same customer within 1 month. Names and credit card account numbers should be scrutinized. Some fraudulent customers will use more than one credit card.

Most refund fraud will usually involve merchandise with low dollar prices. The principal target of refund fraud is almost solely retailers. Wholesalers and manufacturers are rarely victims.

### **18.2.1.2 Bust-Out Artists**

Businesses that extend credit to customers become easy victims of credit fraud. They ship goods to a customer with the expectation of getting paid in the normal 30 days, or sooner with a discount. However, payment is never received. Letters requesting payment are sent. Telephone calls are made only to find out that the telephone has been disconnected or is not operating. This usually happens within a month after shipment of merchandise. The credit manager finds the business premises empty. Inquiries about the business turn up to no avail. The credit manager reports back that the business is nonexistent and the merchandise is gone. The company controller then has to make a write-off of the accounts receivable to bad debts. This causes the company to have a loss or a reduction of earnings

on its financial statements. For some companies, this can be devastating. It could even cause the company to close up shop. This kind of fraud is called bust-out. There are many bust-out artists around that make a living doing this kind of fraud. The surprising part of all of this is that the company does not pursue the bust-out artist. The La Cosa Nuestra, called the Mafia, and other organized crime groups have been doing this for years. They have become experts in this field.

The extent of business credit fraud is not known. The primary reason for this is that businesses do not report such losses, nor do they pursue any criminal prosecution. It is estimated by the National Association of Credit Management that businesses lose tens of hundreds of thousands of dollars. They also have records of people who have operated credit frauds for many years. There are measures that can be taken and warning signs to be aware of to prevent this kind of fraud:

1. The sales department should not control the credit department. The credit department should make the final decision based on its inquiries about the creditor. Remember, it is better to have unsold inventory than to have a bad debt write-off.
2. The company should obtain and study a credit report. The credit manager should call up all previous creditors. However, the credit manager should be cautious of references in the same geographical area, as well as post office boxes and private mailboxes, since these indicate “singers” (phony references).
3. Businesses should call the Better Business Bureau and local or state consumer affairs departments about any complaints and how many. This is a danger sign.
4. Bust-out artists like to have rush orders. This is a ploy to get shipment before a full credit check is made.
5. Credit managers should be wary of unsolicited orders. Bust-out artists try to obtain as many suppliers as possible. They usually want orders shipped immediately without any credit checks.
6. Credit managers should be wary of references located around the country. It is a strong warning sign if the references turn out to be answering machines or answering services.
7. Increases in orders are a danger sign. The bust-out artist sometimes buys small and gradually increases his orders. He also pays promptly, or pays slower on each order. He tries to get your confidence before he makes his last and largest order.
8. Credit managers should be careful of business names that are almost identical to well-known and highly credit worthy corporations. The address given may even be on the same street as that of the reputable concern.
9. The business comes under new management and the change of ownership is not publicly announced and the identity of the new owners is obscure. This is a warning sign.
10. The business should be aware of orders unrelated to the usual line (like a grocery store ordering jewelry as door prizes) during the business’s busy season or the customer’s off-season.
11. The customer orders increased quantities that are contradictory to the seasonal nature of the customer’s business.
12. Financial statements of the customer are unaudited, unverified, and appear inconsistent or unusual. A cash flow should be done to see if the cash balances agree. Also, check ratios to see if they are consistent. Vertical and horizontal analysis



should be performed on the financial statements. If the company is new, it will not have multiperiod financial statements. Therefore, you should compare financial statements with industry statistics and other data to see if they are consistent.

13. If racketeers or those with criminal records are installed in positions of importance with a customer serviced, then credit should not be extended.
14. Credit managers should be aware of an abnormal amount of credit inquiries. Bust-out artists attempt to order from as many companies as possible. The credit manager should be alert to other legitimate references that tell him or her of receiving many inquiries. Credit inquiry rates indicate a strong danger sign.
15. The credit manager should check the backgrounds of the principals. The business must know with whom it is dealing. Credit reports and other financial information should be obtained on the principals regarding their backgrounds and businesses that they have operated in the past.
16. Front men are used by organized crime groups. Organized crime uses front men because they have clean backgrounds. The credit manager must determine if the front men have the capital to start or control the business. Also, do the front men have the experience, education, and knowledge to successfully operate such a business?
17. Payments are made on time at first. As purchases are made, the payments become slower and sometimes checks begin to bounce. When the checks begin to bounce, this is a danger sign and credit should be terminated. This is especially true when orders are also increasing.

### **18.2.2 Employee Fraud**

Employee theft and embezzlement are the most common forms of fraud in businesses. Most employees are not dishonest when they are first hired. They only become dishonest when the opportunity becomes available. Fraud only occurs when three elements come together:

1. Items of value
2. A perpetrator
3. An opportunity

These elements will equal fraud. There are three basic areas where businesses can take steps to help prevent fraud by employees:

1. Hiring
2. Working environment
3. Establishing and maintaining internal controls

#### **18.2.2.1 Hiring**

Hiring honest employees is the first step. Screening prospective employees can help do this. Personnel managers should implement and maintain a thorough selection process. The prospective employee should be screened in regard to both character traits and financial stability. Obtaining the following information can help do this:

1. **Application.** The business should obtain a complete application or resume from the prospective employee. The application and resume should contain:
  - a. Full name. The applicant's full name should be obtained along with any and all aliases and nicknames.
  - b. Identification data. These should consist of date of birth, Social Security number, and driver's license number. If the applicant is a resident alien, then the data should include the INS alien number, the country, and the country-of-origin passport number.
  - c. History. This should contain work history back to the age of 21. The work history should show company names, addresses, and manager/supervisor names of past employers. Any gaps of employment should be questioned and explanations obtained.
  - d. Character references. The prospective employee should give a minimum of three character references. These should not be former employers or relatives.
  - e. Relatives. A listing of close relatives should be obtained. This includes spouse, parents (both applicant's and spouse's), children (with dates of birth), and brothers and sisters (with ages or dates of birth).
2. **Character examination.** The business should have prospective employees take a personal (psychological) character examination. This is strongly urged for prospective employees applying for positions of trust.
3. **References.** The prospective employee character and employment references should be checked. For character references, personnel managers should make inquiries as to the applicant's moral values and religious affiliations. Pastime activities should be identified. The character reference should be examined with regard to the extent of his or her association with the applicant. The applicant's former employers should be examined with regard to the applicant's job performance and skills, reason for leaving the past employer, and punctuality.
4. **Drug test.** The applicant should be examined for any signs of drug and alcohol abuse. Many employees commit fraud because of such abuse. They need the funds to support their habit.
5. **Credit history.** The applicant's credit history should be obtained. This will show his or her financial history and current status. An applicant with a high debt service has a potential of committing fraud. Also, the question of whether the applicant can live off the income at which the employer expects to start him or her should be answered.
6. **Public records.** Public records should be examined as to whether the applicant has any criminal or civil actions. Traffic infractions should not be considered unless the applicant is applying for a driver's position. Also, real and personal property owned by the applicant should be identified in public records.

The above will help the employer evaluate the applicant with regard to his or her fraud potential, and it will supply information about the applicant in case he or she commits fraud. This information will help law enforcement track the fraudulent employee. It will also help in civil tort cases. Subjecting the applicant to such scrutiny will discourage some dishonest individuals from applying and informs employees that fraud will not be tolerated.

### 18.2.2.2 *Work Environment*

Once an employee is hired, an environment should be created that will discourage dishonesty. Treating employees fairly can do this. Employers also can provide amenities, which do not cost very much. They can implement policies that will discourage employees from being dishonest. Internal controls and physical security procedures can be maintained to discourage theft. All of these environmental controls are discussed below:

1. **Amenities.** The business should have amenities that will benefit the employee. These include such things as clean restrooms, a decent break room, a parking space, and clean work space.
2. **Ethical standards.** The business has to promote and display good ethical and moral standards. These standards must be equally applied to employees, managers, and officers. These ethical and moral standards should be applied to employees, vendors and suppliers, and customers alike.
3. **Performance evaluation.** Job performance goals should be high, but not unrealistic. Employees should be encouraged to perform to the best of their abilities. If a business sets unrealistic goals, this will force employees and managers to lie or cheat. Outstanding employees and managers should be rewarded for their performance. Incentives such as bonuses, time off, stock options, etc., should be made available. These awards should be based on performance. Different employees will perform differently. Greater performance should result in greater rewards.
4. **Benefits.** The employer should provide various benefits, which should be available to officers, managers, and employees alike. Health insurance, disability insurance, retirement, and stock options (if a publicly held company) should be made available. Small companies are not financially able to provide many of these benefits at their expense; however, they can make them available to employees at their expense (payroll deductions). Even if the employee has to pay (through payroll deductions) for these benefits, it can be a boost to employee morale and performance. Most employees, especially in hard economic times, want security. If a business has to downsize for whatever reason, then it is up to management to advise the employees. In some cases, particularly for small businesses, management should solicit the cooperation of employees to reduce the downsizing. They should be considered an asset to the business and not an expense.
5. **Internal controls.** Management should implement and maintain internal controls. Internal controls mean more than just establishing administrative procedures. They should include enforcing employees to take vacations, making periodic rotations, and providing training for different assignments. Remember, the more responsibilities that an employee can take on, the more valuable the employee becomes to the business. However, a business should not rely too heavily on any one or two employees for a particular assignment. Internal controls should also encompass security procedures. Change or rotation of guards should be made periodically. Lunch boxes, handbags, etc., should be inspected before managers and employees leave the business site. Limit access to various areas to only employees who work in the area. This is especially true for computers. Work areas should be locked after hours. Access to keys should be limited to appropriate personnel.
6. **Internal auditors.** For medium and large businesses, internal auditors should be employed to act as watchdogs. They should ensure compliance with company

policies and procedures. Internal auditors should be hired by and report to the board of directors. Management should not have any control over internal auditors. Many corporate fraud cases involve upper management who can control internal auditors by directing them away from the area where the fraud is being committed.

Employee theft usually involves the following schemes:

1. Cash register thefts
2. Payroll falsification
3. Issuing fraudulent refunds
4. Kickbacks
5. Embezzlement
6. Lapping schemes
7. Check kiting

These schemes will not be discussed here, since they are explained in more detail in Chapter 23. However, prevention is the primary key to preventing fraud by employees. If items of value and the opportunity do not exist, then employee fraud will be minimal or nonexistent.

### **18.2.3 Vendors and Suppliers**

A third source of fraud upon businesses is by vendors and suppliers. In this scenario, the business is basically the consumer. The previous consumer section addressed the various areas where the consumer can be defrauded. This also applies to businesses as well; however, businesses face additional vulnerabilities. These are addressed below.

#### **18.2.3.1 Kickbacks**

Kickbacks come in various schemes. In any case, it involves an employee and a vendor or supplier. One scheme involves the sale of unreported inventory, which is sold and shared by the vendor and employee. The other scheme involves the business paying for inventory at inflated prices and the employee receiving a portion of the excess. Internal controls can help prevent this, but the key indicators are:

1. The same vendor is constantly used.
2. The current vendor has prices higher than other vendors do in the same line.
3. Inventory reveals more goods in stock whose existence cannot be accounted for.
4. Payments to vendors show more than one endorsement.
5. The manager or purchasing agent has excessive debts.
6. The purchasing agent or manager does not take any vacation time.
7. Only photocopies of invoices are provided.

### **18.2.4 Workers' Compensation**

Workers' compensation fraud is the most common fraud committed. What usually begins as a minor injury on the job develops into a golden opportunity for an early retirement, a paycheck without having to work, or an income supplemented from the insurance company. False information is presented to the workers' compensation carrier. The report

describes the claimant as totally or partially disabled and either unable to work at all or only able to work part time. In many cases, these schemes are enhanced with the assistance of an unscrupulous doctor who, for an extra fee, provides false diagnosis of the claimant's condition and fabricates medical records for phony treatments. Greedy claimants have collected workers' compensation benefits and still work at full- or part-time jobs elsewhere. Some claimants use another name or alias. Workers' compensation claims cause businesses to pay higher rates for insurance. Therefore, fraud is perpetrated on both the business and the insurance carrier. The indicators are:

1. The employee has a history of prior workers' compensation claims.
2. Injuries are soft tissue kinds.
3. The employee claims to be incapacitated but is seen engaging in activities that require full mobility.

### 18.2.5 Surety Bonds

Surety and performance bonds guarantee that certain events will or will not occur. A performance bond guarantees the completion of a construction project, whereas a surety bond protects the public against damages sustained on a construction project. Certain insurance agents specialize in this kind of market and earn an excellent income. Others use the bond market to generate a far greater income by issuing worthless bonds. In this scheme, the unscrupulous salesperson manufactures worthless paper, which is issued to the consumer, usually for high-risk coverage. This might include bridge construction, building demolition, fireworks displays, transportation or storage of explosives, or other potentially hazardous situations. The agent issues the bonds in hopes that no claims will be made. If a claim is made, the agent pays the claim with available funds from other clients, uses delay tactics, or skips out. The indicators of fraudulent agents are:

1. No bond or endorsements are received from the agent.
2. The bond is a photocopy or the bond papers bear no company watermark.
3. The agent requests payments by cash, money order, or cashier's check made payable to him or to a company other than the insurance carrier.
4. Checks are returned, having been cashed or deposited to the agent's personal account.
5. The insurance company allegedly issuing the coverage is not authorized to sell insurance in the state or is unknown to the state insurance department.

## 18.3 Banks

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Criminals like to target banks for various fraud schemes since that is where the money is located. Also, insiders cause many bank frauds. Banks offer many types of services. Each of these services is an area that criminals can target for fraud. The Federal Deposit Insurance Corporation (FDIC) has identified the following danger signs:

1. **Loan participation.** The danger signs in this area are:
  - a. Excessive participation of loans among closely related banks, correspondent banks, and branches or departments of the lending bank

- b. Absence of a formal participation agreement
  - c. Poor or incomplete loan documentation
  - d. Investing in out-of-territory participation
  - e. Reliance on third-party guaranties
  - f. Large pay down or payoff of previously classified loans
  - g. Some indication that there may be informal repurchase agreements on some participation
  - h. Lack of independent credit analysis
  - i. High volume of loan participations sold in relation to the size of the bank's own loan portfolio
  - j. Evidence of lapping of loan participations — for example, the sale of loan participation in an amount equal or greater than, and at or about the same time as, participation that has matured or is about to mature
  - k. Disputes between participating banks over documentation, payments, or any other aspect of the loan participation agreements
2. **Secured lending; real estate and other types of collateral.** The danger signs in this area are:
- a. Lack of independent appraisals.
  - b. Out-of-territory loans.
  - c. Evidence of land flips. A land flip is a process in which individuals or businesses buy and sell properties among themselves, each time inflating the sales price to give the appearance of rapidly increasing property values. The mortgage amounts increase with each purchase until, in many cases, the amounts of the mortgages greatly exceed the actual values of the mortgaged property.
  - d. Loans with unusual terms and conditions.
  - e. Poor or incomplete documentation.
  - f. Loans that are unusual considering the size of the bank and the level of expertise of its lending officers.
  - g. Heavy concentration of loans to a single project or to individuals related to the project.
  - h. Concentrations of loans to local borrowers with the same or similar collateral that is located outside the bank's trade area.
  - i. Asset swaps. Sale of other real estate or other distressed assets to a broker at an inflated price in return for favorable terms and conditions on a new loan to a borrower introduced to the bank by the broker. The new loan is usually secured by property of questionable value and the borrower is in a weak financial condition. Borrower and collateral are often outside the bank's normal trade area.
  - j. Failure to consider the risk of decline in collateral value.
3. **Insider transactions.** The danger signs in this area are:
- a. Financing the sale of insider assets to third parties.
  - b. From a review of personal financial statements, evidence that an insider is lending his own funds to others.
  - c. Improper fees to major shareholders.
  - d. Frequent changes of auditors or legal counsel.
  - e. Unusual or unjustified fluctuations in insiders' or officers' personal financial statements or statements of their interests.

- f. Frequent appearances of suspense items relating to accounts of insiders, officers, and employees.
  - g. An insider's borrowing money from someone who borrows from the bank.
  - h. Purchase of bank assets by an insider.
  - i. A review of the bank's fixed assets or other asset accounts reveals that the bank owns expensive artwork, expensive automobiles, yachts, airplanes, or other unusual items that are out of character for a bank of its size and location.
  - j. A review of the bank's expense accounts reveals expenditures for attorneys' fees, accountants' fees, brokers' fees, etc., that do not appear to correspond to services rendered to the bank or that appear unusually high for services rendered.
  - k. Heavy lending to the bank's shareholders, particularly in conjunction with recent capital injections.
  - l. A large portion of the insiders' bank stock has been pledged to secure debts to other financial institutions.
  - m. An insider has past-due obligations at other financial institutions.
  - n. An insider is receiving all or part of the proceeds of loans granted to others.
  - o. An insider is receiving special consideration or favors from bank customers. For example, an insider may receive favorable lease terms or favorable purchase terms on an automobile obtained from a bank customer.
4. **Credit card and electronic funds transfer.** The danger signs in this area are:
- a. Lack of separation of duties between the card-issuing function and the issuance of a personal identification number (PIN).
  - b. Poor control of unissued cards and PINs.
  - c. Poor control of returned mail.
  - d. Customer complaints.
  - e. Poor control of credit limit increases.
  - f. Poor control of name and address changes.
  - g. Frequent malfunction of payment authorization system.
  - h. Unusual delays in receipt of cards and PINs by customers.
  - i. Bank does not limit amount of cash a customer can extract from an ATM in a given day.
  - j. Evidence that customer credit card purchases have been intentionally structured by a merchant to keep individual amounts below the floor limit to avoid the need for transaction approval.
5. **Wire transfers.** The danger signs in this area are:
- a. Indications of frequent overrides of established approval authority and other internal controls.
  - b. Intentional circumvention of approval authority by splitting transactions.
  - c. Wire transfers to and from bank secrecy haven countries.
  - d. Frequent large wire transfers to persons who do not have an account relationship with the bank.
  - e. In a linked financing situation, a borrower's request for immediate wire transfer of loan proceeds to one or more banks where the funds for brokered deposits originated.
  - f. Large or frequent wire transfers against uncollected funds.
  - g. Wire transfers involving cash where the amount exceeds \$10,000.

- h. Inadequate control of password access.
  - i. Customer complaints and frequent error conditions.
6. **Offshore transactions.** The danger signs in this area are:
- a. Loans made on the strength of a borrower's financial statement when the statement reflects major investments and income from businesses incorporated in bank secrecy countries.
  - b. Loans to offshore companies.
  - c. Loans secured by obligations of offshore banks.
  - d. Transactions involving an offshore shell bank whose name may be very similar to the name of a major legitimate institution.
  - e. Frequent wire transfers of funds to and from bank secrecy countries.
  - f. Offers of multi-million-dollar deposits at below-market rates from a confidential source, to be sent from an offshore bank or somehow guaranteed by an offshore bank through a letter, telex, or other "official" communication.
  - g. Presence of telex or facsimile equipment in a bank where the usual and customary business activity would not appear to justify the need for such equipment.
7. **Third-party obligations.** The danger signs in this area are:
- a. Incomplete documentation.
  - b. Loans secured by obligations of offshore banks.
  - c. Lack of credit information on third-party obligor.
  - d. Financial statements reflect concentrations of closely held companies or businesses that lack audited financial statements to support their value.
8. **Corporate culture ethics.** The danger signs in this area are:
- a. Absence of a code of ethics.
  - b. Absence of a clear policy on conflicts of interest.
  - c. Lack of oversight by the bank's board of directors, particularly outside directors
  - d. Absence of planning, training, hiring, and organizational policies.
  - e. Absence of clearly defined authorities and lack of definition of the responsibilities that go along with authorities.
  - f. Lack of independence of management in acting on recommended corrections.
9. **Miscellaneous.** Other danger signs include:
- a. Indications of frequent overrides of internal controls or intentional circumvention of bank policy.
  - b. Unresolved exceptions of frequently recurring exceptions on exception reports.
  - c. Out-of-balance conditions.
  - d. Purpose of loan is not recorded.
  - e. Proceeds of loan are used for a purpose other than purpose recorded.
  - f. A review of checks paid against uncollected funds indicates that a customer is offsetting checks with deposits of the same or similar amount and maintains a relatively constant account balance, usually small in relation to the amount of activity and the size of the transactions.



## 18.4 Summary

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The best things that businesses can do to prevent fraud are:

1. Establish and adhere to high moral and ethical standards by management.
2. Prosecute any employee who commits fraud. Failure to do so will only encourage other employees to do the same.
3. Establish and adhere to internal controls.
4. Install and use various detection devices for customer-oriented business. Restrict access to only certain employees where customers and other employees have no business or need.



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## 19.1 Introduction

Money laundering was not considered a crime until the 1980s, when Congress passed a series of laws that made it a crime. Organized crime groups have laundered gains from illegal activities for many years. However, money laundering activities were not legally addressed until laws were passed in the 1980s. Fraud examiners are called upon to unravel various money laundering schemes. There are many accounting and auditing techniques that can be used to detect these schemes, and the fraud examiner should be well versed in their use.

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## 19.2 Definition

Money laundering is defined as “washing” proceeds so as to disguise their true source. The source of these proceeds can be from either legal or illegal activities. The things that a money launderer wants to accomplish are to move money, reduce its volume, and change its character to allow for spending or investing, while sheltering it from detection and taxation. All of these actions are forms of money laundering. While it comes up quite often in drug trafficking and other organized crime operations, money laundering is not limited to that area. It also comes up in bookmaking, loan-sharking, skimming business receipts, etc. With the passage of the Patriot Act in 2001, financing terrorism has been included in money laundering. The Patriot Act has also increased the civil and criminal penalties for money laundering.

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## 19.3 History

Congress began a long series of steps to combat money laundering. The first step was the passage of the Bank Secrecy Act in 1970. Its purpose was to identify money launderers and tax evaders. In 1984, Congress passed the Deficit Reduction Act, commonly known as the Tax Reform Act of 1984. Congress added Internal Revenue Code Section 6050I to enable the Internal Revenue Service to discover unreported income, from legal or illegal sources, by identifying taxpayers involved in large cash transactions. Section 6050I requires infor-

mation returns to be filed (using Form 8300) by all trades or businesses for cash transactions over \$10,000. It further requires that these forms be filed within 15 days of the cash being received and that 8300 forms be filed when all payments aggregate to more than \$10,000. Also, the reporting requirement is imposed to any receipt of cash in connection with a trade or business, regardless of whether the receipt constitutes income in the trade or business. Cash is defined as coin and currency of the U.S. or any other country that is circulated in and is customarily used and accepted as money in the country in which it is issued. Cash does not include bank checks, traveler's checks, bank drafts, wire transfers, or other negotiable or monetary instruments.

In 1986, Congress passed the Anti-Drug Abuse Act. This act subjects persons to criminal liability for knowingly participating in any laundering of money. It added money laundering schemes to include wire transfers. It increased fines and penalties and promotes the international exchange of information.

In 1988, Congress passed the Omnibus Drug Bill II, commonly called the Anti-Drug Abuse Act of 1988. This bill forbids financial institutions from issuing or selling bank checks, traveler's checks, or cashier's checks in connection with cash of \$3,000 or more unless the person has an account. It also requires additional record-keeping requirements. Additional penalties are imposed on financial institution officers, directors, and employees. The Treasury Department is required to negotiate with foreign countries.

In 2001, Congress passed the U.S. Patriot Act. This act has increased penalties, civil and criminal, for money laundering activities. It has also imposed requirements on various financial institutions. For U.S. banks, it requires their foreign correspondent banks and subsidiaries to maintain information about their customers. A U.S. bank cannot administer, manage, or establish a correspondent bank in a foreign country that does not have a physical presence in any country. The act has allowed financial institutions to share information about their customers with other banks.

## **19.4 Government Reporting Forms**

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The laws passed by Congress require various forms to be filed with the Internal Revenue Service at the Detroit Computing Center in Detroit. The Financial Crimes Enforcement Network, called FinCen, is empowered to assess penalties for failure to file or file fraudulent forms. Some forms are required to be filed with the Internal Revenue Service.

### **19.4.1 FinCen Form 104 (Formerly Form 4789), Currency Transaction Report (CTR) (Exhibit 19.1)**

This form is to be filled out by financial institutions that report currency transactions exceeding \$10,000 to the Treasury Department. Financial institutions are broadly defined and have since been expanded. Some of these financial institutions and persons are:

1. Banks and trust companies
2. Thrift institutions
3. Brokers and dealers in securities
4. Pawn brokers
5. Currency exchangers
6. Check cashing stores

7. Auto dealers
8. Real estate businesses
9. U.S. Postal Service (money orders)
10. Issuers, sellers, or redeemers of money orders and traveler's and cashier's checks
11. Transmitters of funds
12. Telegraph companies
13. Casinos
14. Loan companies

These financial institutions and persons must file these reports within 15 days of the date of the transaction. Also, the financial institution or person must retain copies or maintain a log of these transactions for 5 years. Currency is defined to include coins or paper of the U.S. or any other country, but not negotiable instruments.

#### **19.4.2 FinCen Form 105 (Formerly Form 4790), Report of International Transportation of Currency or Monetary Instruments (CMIR) (Exhibit 19.2)**

Any person who transports cash or bears instruments into or out of the U.S. requires this form. The CMIR is to be filed at the time of entry or departure from the U.S. with U.S. Customs. Monetary instruments are defined, as amended, to include:

1. U.S. and foreign coin and currency
2. Bearer-negotiable instruments (personal checks, business checks, bank checks, cashier's checks, promissory notes, and money orders)
3. Bearer stock and securities

Transportation is defined to include physical mailing and shipping, as well as carrying.

#### **19.4.3 Form 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR) (Exhibit 19.3)**

This form requires a person to report any transaction that he or she has with a foreign financial institution. Accounts with domestic branches of foreign banks are exempt from this requirement. The report requires the aggregation of separate accounts regardless of whether they are located in one or more foreign countries. This form is required to be filed by June 30 of each calendar year with respect to foreign financial accounts exceeding \$10,000 during the previous calendar year. This requirement is in addition to the block on Form 1040, Schedule B.

#### **19.4.4 Form 8300, Report of Cash Payments over \$10,000 Received in a Trade or Business (Exhibit 19.4)**

This form must be filed by any business that receives more than \$10,000 in cash in one or more related transactions. Transactions are related even if they are longer than 24 hours. For example, a jewelry dealer sells a diamond ring for \$18,000. He receives \$9,000 and 2 weeks later gets the remaining \$9,000. At the time of receiving the second \$9,000, the jewelry dealer must file the 8300 within 15 days.

### **19.4.5 Form 8362, Currency Transaction Report by Casinos (Exhibit 19.5)**

This form requires casinos in the U.S. to report cash of more than \$10,000 received or disbursed in a gaming day. Multiple transactions must be treated as a single transaction. The report must be filed by the 15th day following the transaction.

### **19.4.6 Form TD F 90-22.55, Registration of Money Services Business (Exhibit 19.6)**

Any money service business must register by filling out this form and sending it to the IRS Detroit Computing Center within 180 days of beginning business operations. Money service businesses are money transmitters, currency exchangers, check cashers, and issuers, sellers, or redeemers of traveler's checks or money orders.

### **19.4.7 Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts (Exhibit 19.7)**

This form is due at the same time as the Individual Income Tax Return. A joint 3520 can only be filed when a joint return is filed. This form goes to the Internal Revenue Service Center in Philadelphia, PA.

### **19.4.8 Suspicious Activity Report (SAR) (Exhibit 19.8)**

All financial institutions are required to file a suspicious activity report when they suspect violations. This form helps the institution to provide the necessary information. The report is to be filed no later than 30 days after the date of initial detection of facts; however, an additional 30 days can be used to identify a suspect. The report is not required for robberies and burglaries that are reported to local authorities. This does not alleviate filing the CTR. There are special SAR forms for brokers, casinos, and money service businesses.

### **19.4.9 Forms and Instructions**

The above forms are provided in this chapter, as well as their instructions, which provide more detailed information about the forms.

## **19.5 Penalties**

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There are penalties for not filing or filing false forms to the government. The penalties are divided into two categories: civil and criminal. Both civil and criminal penalties for each form are summarized below:

### **19.5.1 FinCen Form 104**

The civil and criminal penalties for failure to file or filing false forms are:

**Civil.** For any willful violation, a civil penalty of not more than \$100,000 involved in the transaction or \$25,000. The penalty can be assessed upon the person or institution for the amount of coins or currency involved in the transaction, but

shall be reduced by any forfeiture. A separate violation occurs for each day the violation continues and at each office, branch, or place of business.

**Criminal.** Anyone who willfully fails to file or files false reports shall be fined upon conviction not more than \$250,000 or be imprisoned not more than 5 years, or both. If criminal acts are committed as part of a pattern of illegal activity involving transactions exceeding \$100,000 in any 12-month period, then the penalty, upon conviction, is a fine of not more than \$500,000 or imprisonment for not more than 10 years, or both.

### 19.5.2 FinCen Form 105

The civil and criminal penalties for failure to file or filing false forms are the same: a fine of not more than \$500,000 and imprisonment of not more than 10 years can be imposed. Also, the currency or monetary instrument may be subject to seizure and forfeiture.

### 19.5.3 Form 8300

The penalties for willful failure to file or filing false reports are as follows:

**Civil.** If the person or business fails to file or provide the required statement to those named in Form 8300, then the minimum penalty is \$25,000 or the amount of cash received.

**Criminal.** The criminal penalties for willful failure to file, filing false or fraudulent forms, stopping or trying to stop filing, and setting up, helping to set up, or trying to set up a transaction in a way that would make it seem unnecessary to file are a fine of up to \$250,000 (\$500,000 for corporations) or a prison sentence of up to 5 years, or both.

### 19.5.4 Form 90-22.1

The civil and criminal penalties for failure of individuals or businesses to file or for filing false reports are:

**Civil.** For failure to file or for filing false reports, the penalty is \$25,000 or the amount of the transaction, not to exceed \$100,000.

**Criminal.** Any person or business that violates this provision shall be fined not more than \$250,000 or be imprisoned not more than 5 years, or both. In cases of a pattern of illegal activity involving transactions exceeding \$100,000 in any 12-month period, the criminal penalties, upon conviction, are a fine of not more than \$500,000 or imprisonment of not more than 10 years, or both.

### 19.5.5 Form 8362

The civil and criminal penalties for failure to file or filing false forms by casinos are:

**Civil.** For any willful violation, a civil penalty of not more than \$100,000 involved in the transaction or \$25,000. The penalty can be assessed upon the person or institution for the amount of coins or currency involved in the transaction, but

shall be reduced by any forfeiture. A separate violation occurs for each day the violation continues and at each office, branch, or place of business.

**Criminal.** Anyone who willfully fails to file or files false reports shall be fined upon conviction not more than \$250,000 or be imprisoned not more than 5 years, or both. If criminal acts are committed as part of a pattern of illegal activity involving transactions exceeding \$100,000 in any 12-month period, then the penalty, upon conviction, is a fine of not more than \$500,000 or imprisonment for not more than 10 years, or both.

### 19.5.6 Registration of Money Services Business

Failure to register a money service business can result in penalties as follows:

**Civil.** Any person who fails to register, keep records, or maintain agent lists shall be liable for a penalty of \$5,000 for each violation.

**Criminal.** The criminal penalties are a fine and imprisonment up to 5 years.

### 19.5.7 Form 3520

A penalty generally applies if Form 3520 is not filed in a timely manner or if the information is incomplete or incorrect. Generally, the penalty is:

1. Thirty-five percent of the gross value of any property transferred to a foreign trust for failure by a U.S. transferor to report the transfer
2. Thirty-five percent of the gross value of the distributions received from a foreign trust for failure by a U.S. person to report receipt of the distribution
3. Five percent of the amount of certain foreign gifts for each month for which the failure to report continues (not to exceed 25%)

If a foreign trust has a U.S. owner and the trust fails to file the required annual reports on trust activities and income, the U.S. owner is subject to a penalty equal to 5% of the gross value of the portion of the trust's assets, treated as owned by the U.S. person.

## 19.6 Schemes

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Suppose a person has received income, legal or illegal, and wants to hide it from others. The person can hide it under his mattress or elsewhere, but that would leave the person vulnerable to theft, and he would not get the benefit of spending or investing the money. If the proceeds are in small denominations, then the person has the problem of exchanging the small bills for larger bills. Spending large bills could cause unwanted attention to the person. Also, a large amount of bills is cumbersome to carry or transport. A million dollars in \$20 bills weighs 113 pounds and can fill nearly four file storage boxes. The person usually starts to convert the money to readily acceptable forms, i.e., money orders, traveler's checks, etc. In many cases, the person will open up more than one bank account and make frequent deposits into them. There is usually more than one bank involved. *Smurfing* is the term used for a person making deposits into various bank accounts on the same or subsequent days. *Structuring* is the term used for a person making more than one deposit into the

same or various bank accounts at the same bank or financial institution. If the person has no legitimate source of income, then the person will want to acquire a business so that the money can be run through it. The business would pay a salary or would loan the person money. The person may even transfer money to foreign bank accounts with bank secrecy laws.

A financial institution can be involved in money laundering. A drug dealer drops off cash at the bank. The bank wires the funds to an offshore account, usually to a certificate of deposit. Then the bank makes a loan to the drug dealer and gives him back some of the cash or deposits it into a bank account. The certificate of deposit is the collateral for the loan. The Bank of Credit and Commerce International (BCCI) was convicted of this scheme in the U.S.

Another scheme is to buy gold and diamonds. The dealer, of course, does not file any 8300 forms. Gold and diamonds are not as bulky as currency, and thus can be transported easily.

Sophisticated money launderers will deposit cash in offshore bank accounts. The bank account is in a corporation's name. The corporation in turn issues bearer bonds or stock. Bearer bonds or stock can be used the same way as cash. They can be redeemed for the face amount. The face amount can be for large amounts, such as \$100,000 or more. A drug dealer can pay for his drugs using bearer bonds. In the U.S., bearer bonds and stock are not legal, but they are legal in some countries, including some tax haven countries.

## 19.7 Hawala

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A hawala is a money transfer without the movement of money. A person gives funds to another person (called a hawala) for transfer to another country. The hawala sends a fax or calls his contact in another country to provide funds to someone there. The person gives the funds to the other person in the other country. The hawala in this country charges a commission for making the transfer and keeps a record of the amount owed to the person in the other country. The person in the other country shows a receivable on his books. In time, the two hawalas' books will be balanced by either settling up or other transactions. This scheme requires a great amount of trust between the two hawalas.

## 19.8 Business

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Money laundering in businesses involves four principal methods:

1. **Balance sheet.** Balance sheet money laundering encompasses making cash deposits into a business bank account. The person writes checks using that money. The deposits are credited to shareholder loans or an equivalent account, and the checks are charges against shareholder loans. The taxpayer avoids paying income taxes on the funds in this case.
2. **Overstating revenue.** The person makes deposits into the business bank accounts and charges them to legitimate income. The person uses the funds to pay himself or relatives salaries or their expenses.



3. **Overstating expenses.** The person pays wages for nonexistent employees or pays for supplies or services that he never receives. Another version is to pay cash for items at a discount. The discount is not recorded on the invoice. The books show that the full price was paid for the item.
4. **Shifting of income.** Another method used by criminals is to shift income offshore. Terrorists want to shift income here. This scheme involves selling goods to an offshore entity at below-market value. The goods are sold in the offshore country at market value. In essence, the income is shifted offshore. Terrorists sell goods to an offshore entity at market or above-market prices, and the income is transferred here. In some cases, the organization here is a nonprofit entity, so no income is reported or taxes paid.

## 19.9 Trusts

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Some criminals use trusts to hide funds or assets. It can be as simple as having an individual, such as an attorney, hold title to real or personal property in their name as trustee. Trusts can be complex, though. The trustee holds income-producing property, real or personal, for the grantor. The trustee collects the income and pays the expenses for the trust property. The trustee will charge fees for this service, usually based on the time spent in administering the trust. The trustee will file tax returns for the trust and pay the taxes. The grantor of the trust can also be the beneficiary. In some cases, the trust does not pay taxes, but passes the income down to the grantor or beneficiaries. The trustee can be almost anyone — a bank or trust company, insurance company, attorney, accountant, relative, or close friend.

The fraud examiner must view trusts in terms of hiding assets by the criminals. The difficulty with trusts is connecting the trust and its assets to the grantor or beneficiary. Trust agreements are not recorded in public records, for the most part. They are generally not filed with federal or state tax authorities, except during tax examinations. Therefore, other investigative techniques have to be used. Criminals like to and want to hide ownership of real or personal property; however, they do not want to relinquish control over the property. Fraud examiners and law enforcement must look to the control factor for uncovering hidden ownership. Observing the following can help accomplish this:

1. The criminal constantly uses the property while it is titled to a trustee.
2. Title to the property is transferred to the trust, but the liability is still retained by the grantor.
3. The grantor has inadequate income history to have allowed for such cash accumulation or asset purchase.
4. The grantor and trustee sign documents jointly for the property and related liabilities.
5. The grantor transfers property to the trust during a bond hearing after just being arrested for criminal activities.
6. The grantor is present when the purchase is made.
7. The grantor has possession of personal property titled to the trust.
8. The grantor pays rent to the trust for use of trust property. Usually, the grantor pays rent at either below-market or higher-than-market values in the same area.
9. The grantor has to provide funds to the trust to keep it liquid or stable.

10. The grantor owned the property prior to the trust. He made the transfer prior to his criminal activities so as to have future or current benefit of the property or so his children would have an inheritance.

### 19.9.1 Nominees

A nominee is a person designated to act for another as an agent or trustee. Criminals use nominees to hide assets. In some cases, nominees are involved with the criminals in the illegal activities. Another version of nominees is called the alter ego. Alter ego refers to corporate and business entities that are intermixed so that their income and assets are not separable. The fraud examiner must look to the possibility of criminals using nominees and alter egos (when businesses are involved) for hiding assets. Indicators of nominees and alter egos are as follows:

1. A close or suspected relationship exists between the parties. Examples include:
  - a. Blood or marriage relationship
  - b. Length of association
  - c. Common address
  - d. Same corporate stockholders, directors, officers, employees, attorneys, accountants, etc.
2. Inadequate consideration by the nominee or alter ego is given for assets purchased from the criminal. Examples include:
  - a. An asset transfer without a transfer of the matching liabilities.
  - b. Inadequate deed stamps.
  - c. Book value transfer of an appreciated property.
  - d. Use of the term *gift* on vehicle title transfers (usually done to evade state sales tax).
  - e. Payment of a long-term, low-interest note without adequate security.
  - f. Alleged consideration was for an “assumption of liabilities” by the purchaser.  
If so: Were the assumed liabilities less than the value of the transferred property?  
Did the criminal continue to satisfy the liabilities?
3. The nominee or alter ego does not have the ability to pay for the asset. Examples include:
  - a. Inadequate income history reported by the nominee to have allowed such cash accumulation.
  - b. Interest deductions on tax returns showing large debts of the nominee or alter ego.
  - c. Lack of dividend/interest income sources.
  - d. Nominee is too young to have accumulated funds.
  - e. Financial statements in obtaining credit cards, applying for bank loans, opening bank accounts, or making an installment purchase show inability to acquire assets.
  - f. Co-signing by the criminal may show that the nominee’s credit record or the criminal’s collateral were responsible for the loan.
  - g. A paper trail through the bank or savings account is lacking.
  - h. The nominee is on welfare or social security.
4. The criminal has the ability to pay for the asset. Examples include:

- a. The likely source of income from illegal acts.
- b. The criminal's lifestyle.
- c. Liquidations by the criminal prior to the nominee's purchase of an asset.
- d. The criminal was present when the seller received the proceeds.
5. The nominee has the ability to operate the asset. Examples include:
  - a. Inexperience or lack of education of nominee
  - b. Complexity, special skill, or experience required by nominee and possessed by the criminal
  - c. No business or occupational license by nominee
  - d. Lack of physical strength or stamina by nominee
  - e. Lack of zoning clearance with the nominee's alter ego location
6. The criminal has continued use and possession. Examples include:
  - a. Asset at criminal's address.
  - b. Insurance shows criminal as operator or occupant.
  - c. The criminal physically drives, occupies, repairs, maintains, etc., the asset.
  - d. There is no change of asset use after the supposed transfer.
  - e. The keys (to the car, house, safety deposit box, business, etc.) are in the criminal's or his attorney's possession.
  - f. The criminal uses the asset but pays no rent or grossly excessive rent to the nominee.
7. The criminal maintains control. Examples include:
  - a. The criminal's senior status in the family.
  - b. The criminal's supervision, hiring, and firing of employees and officers.
  - c. The criminal has access and signatory authority over the nominee's bank accounts.
  - d. The criminal makes contracts or orders repairs for the nominee's assets.
  - e. The personal expenses or perks are by the nominee.
8. The nominee knew or should have known of skimming or other unclean funds. Examples include:
  - a. Spouse or other close relative can almost never claim ignorance, especially if he or she works in the business with the criminal.
  - b. The related corporations have the same officers, accountants, employees, etc.; they are in an awkward position to allege ignorance.
  - c. Illegal use of the corporation is valid grounds for piercing the corporate veil or dissolving the corporation.
9. The nominee fails to observe corporate formalities, for example:
  - a. Improper incorporation
  - b. Undercapitalization
  - c. Failure to file tax returns, federal and state
  - d. Acting outside corporate charter
  - e. Failure to obtain various tax numbers
  - f. Failure to maintain corporate books and minutes
  - g. Failure to obtain stock subscription payments from stockholders
  - h. Failure to appoint officers
  - i. Failure of directors to meet
  - j. Loss of charter or dissolution by proclamation
  - k. Failure to register in state

1. Commingling of assets
10. The criminal has continued financial liability in addition to the nominee's financial liability. Examples include:
  - a. Mortgage or installment debt still in the criminal's name
  - b. State or local property tax records in the criminal's name
  - c. Utility bills (phone, water, and electric) in the criminal's name
  - d. Rent paid by criminal
  - e. Criminal co-signed note
11. The nominee committed perjury, has a propensity for concealment, or is inherently untrustworthy. Examples include:
  - a. The nominee makes misrepresentations, either oral or on financial statements.
  - b. The nominee has a criminal record or pending charges.
  - c. A foreign corporation (offshore) loans or invests funds to the nominee or corporation.
12. The criminal has the propensity, history, or habit of using fraudulent devices. Examples include:
  - a. The criminal has an illegal occupation.
  - b. Past history of successful or unsuccessful fraudulent transfers.
  - c. Lies to law enforcement.
13. Times show fraud. Examples include:
  - a. There is extreme haste in incorporating, in closing on real estate, or in weekend/holiday asset transfers.
  - b. The transfer is prior to incorporation or while the corporation is inactive or dissolved.
  - c. The transfer or sale occurs in the middle of a busy or lucrative season or before contract completion and right to receive payment.
  - d. The nominee acquires an asset just after the criminal obtains money from the sale of a different asset.
14. There are purchase or transfer irregularities. Examples include:
  - a. Undocumented or unrecorded transfer
  - b. Oral agreement
  - c. The purchase contract is signed by the criminal, but title is taken by the nominee.
  - d. The criminal sells or conveys to the nominee without:
    - 1) An appraisal
    - 2) A competitive bid
    - 3) Advertising
    - 4) Showing or exhibiting the property to the nominee
    - 5) The nominee ever learning about the conveyance
    - 6) Advising the mortgage holder
    - 7) Cash to the criminal, only a note
    - 8) A written rental agreement for future use by the criminal
15. There are admissions of ownership by the criminal. Examples include:
  - a. Failure by criminal to report gain or loss on alleged sale of asset to the nominee to tax authorities.
  - b. The criminal lists nominee assets on financial statements given to creditors.
  - c. Statements of ownership to customers, suppliers, or neighbors.

- d. Testimony in divorce proceedings regarding ownership.
- e. Statements under oath of ownership on homestead exemption forms, required contractual disclosure statements in litigation against third parties, license applications, etc.
- f. Statements to accountants, employees who are fired, or spouses or relatives.

## 19.10 Offshore

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More sophisticated money launderers like to smuggle currency offshore and deposit it into a foreign bank account. These funds are later wired back to the U.S. as a foreign investment of some type, e.g., loans or capital investment. Tax authorities and accountants call most of these foreign countries tax havens. Tax haven countries are those that have the following characteristics:

1. **No or low taxes.** Tax haven countries have either no or low taxes, which attract deposits and capital investments.
2. **No exchange controls.** Tax haven countries have no monetary exchange controls. A person can transfer funds in and out of a tax haven country without any interference from local authorities. Also, funds can be exchanged from one currency to another and can be transferred quickly in and out of the country by electronic means. Additionally, currency can be converted to various commodities, i.e., gold, silver, platinum, etc.
3. **Bank facilities.** Tax haven countries attract many foreign and domestic banks. They encourage banks to have modern facilities and provide the services offered in other industrialized countries. Tax haven countries have banking laws that control and encourage the industry.
4. **Bank secrecy.** Tax haven countries have bank secrecy laws or customs. They do this primarily to help people conceal the fact that they have accounts in that country. Tax authorities in other countries are not allowed to obtain any information about people's bank accounts in the tax haven country. However, some tax haven countries will provide banking information if the request clearly shows violations that are not related to taxes. Some tax haven countries do not want the image of being a haven for drug traffickers.
5. **Stability.** Tax haven countries have good political and economic stability. People do not want to have bank accounts in countries that are politically or economically unstable. Why should someone deposit funds in a country that is being ravished by civil war or guerrilla warfare?
6. **Communications.** Tax haven countries have good communication facilities. This is necessary for people to be able to transfer funds back and forth. Large amounts of money can be wired from one country to another very rapidly. If communication facilities were not available, then this would not be possible. Criminals have to have easy access to funds.
7. **Corruption.** Tax haven countries have to be free of corruption. People do not like to make payoffs to public officials for hiding or maintaining funds in that country. However, organized crime groups like to make payoffs to public officials so that they ignore or do not interfere with the criminals' operations.

Multinational corporations use tax haven countries to avoid various taxes as well as route funds to subsidiaries. This is legal. Avoiding taxes is legal; evading taxes is illegal. Some elements use tax havens to hide their gains or assets. Other people use tax havens for investment. The difference between hiding gains or assets and investments can be a very fine line. Some people will form a corporation offshore and deposit funds into a bank account for that corporation. A case where this is legal: A professional may form an insurance company offshore. The professional writes checks to the foreign insurance corporation and expenses them on the business books. Policies are written for malpractice or liability insurance from the offshore insurance company. If a claim is made, the offshore corporation pays the claim. This is legal. However, it would be illegal if the funds were solely used to hide gains or assets and no claims were paid. Funds small to the amount of coverage or claim would strongly indicate the hiding of assets, especially if no claims were made or the policy was not issued or disclosed. The ratio of premiums to the face amount of coverage should be compared to industry averages. If premiums are lower or coverage is higher than industry averages, then this indicates money laundering.

### 19.10.1 Offshore Entities

When a fraud examiner comes across an offshore entity, he has to make a determination as to whether this entity is legitimate. Determining the following factors can help:

1. **No payments or repayments.** The subject has no evidence of making payments or repayments. The offshore entity does not loan or provide products or services without some compensation or repayments. The absence of any payments or repayments clearly indicates a shell entity.
2. **Not U.S. registered.** In most states, foreign entities cannot do business unless they are registered with the appropriate agency. Failure to get registered bars their legal rights in that state. If an offshore entity makes a loan to a customer, but is not registered in that state, it does not have any recourse if the customer fails to make payments.
3. **Failure to file tax returns.** If the offshore entity does business in the U.S., it is required to file income tax returns, even if no tax liability exists. Foreign entities are required to pay taxes on income earned in the U.S.
4. **No place of business.** If the offshore entity has no business location in this country or in the country of origin, then it is a shell entity. Tax haven countries commonly have entities that are registered. Only the registered agent or representative is listed on the country's register. However, when the fraud examiner tries to find such entity, the entity is nothing more than a book or piece of paper in an attorney's office. It has no business location in either the U.S. or the country of origin.

If a financial transaction meets all or most of the above criteria, then it is a sham entity. It only serves to cover up the true source and ownership of the funds used. Many criminals and organized crime groups use this scheme to hide income and assets. In one case, a drug trafficker borrowed \$800,000 from a Panamanian corporation to finance a house. The mortgage was duly filed in the county public records. The Panamanian corporation had no business location in either the U.S. or Panama, nor was it registered in the U.S. Further investigation revealed that the corporation was a shell. In another case, an individual

borrowed funds to finance a house. The mortgage was written so that the borrower would not have to make repayments on the mortgage until 30 years later, when principal and interest were due. The individual was 60 years old. Also, the individual's son was the sole shareholder of the mortgage company and a known drug trafficker. The corporation was an offshore one located in the Cayman Islands, a tax haven country. The corporation had no business location in the Cayman Islands or in the U.S. These are examples of using offshore entities to cover up illegal gains or assets.

## 19.11 Record Keeping

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Taxpayers are required to keep both tax and bank records. Title 26, Section 6001 USC, requires taxpayers to keep permanent books of such accounts or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown by such person on any return or information. The regulations empowered area directors to require any person, by notice served upon him, to keep such specific records as will enable the area director to determine if records are adequate, regardless of whether such person is liable for tax. Taxpayers are required to keep records for at least 3 years, and in some cases even longer. Title 31 requires more specific record keeping and retention. Congress declared that adequate records must be maintained by banks, businesses, and individuals engaging in the business of carrying on as a financial institution, defined in 31 USC 5312(a) and 12 USC 1953. Individuals engaging in transactions or maintaining a relationship with a foreign financial agency have a high degree of usefulness in criminal, tax, and regulatory investigations and proceedings. In 31 Code of Federal Regulations (CFR) 103, the secretary promulgated regulations requiring records to be maintained for 5 years and filed or stored in such a way as to be accessible within a reasonable period. A person having financial interests in foreign financial institutions is required to file the FBAR and retain records containing:

1. The name in which each such account is maintained
2. The number or other designations of such account
3. The name and address of the foreign bank or other person with whom such account is maintained
4. The type of such account
5. The maximum value of each such account

The 5-year retention period is extended beginning with the date on which the taxpayer is indicted or information is instituted on account of the filing of a false or fraudulent federal income tax return, and ending with the date on which final disposition is made of the criminal proceeding.

Financial institutions must retain either the original or a microfilm or other copy or reproduction of records containing the name, amount, nature or purpose, and date regarding extension of credit exceeding \$10,000, which are not secured by real property. In addition, financial institutions are required to keep records regarding advice, request, or instruction received or given concerning any transaction resulting in the transfer of currency or other monetary instruments, funds, checks, investment securities, or credit of more than \$10,000 to or from any person with an account or place outside the U.S.

Additionally, banks are required to keep the customer's name, address, and identification number for all accounts opened after June 30, 1972, or certificates of deposit sold or redeemed after May 31, 1978. Also, banks are required to keep documents granting signature authority, and any notations of specific identifying information, such as driver's license or credit card numbers. They must keep account statements showing each transaction, e.g., checks, drafts, or money orders issued or payable by the bank or other debit items, unless \$100 or less, or certain checks drawn on accounts that can be expected to have drawn on them an average of at least 100 checks per year. Deposit slips or credit tickets reflecting transactions in excess of \$100 containing the amount of currency must be maintained.

Brokers, dealers in securities, casinos, and currency dealers or exchangers are required to keep records identifying name, address, Social Security number, and documents granting signature or tracing authority over each customer's account. A record of each remittance or transfer of funds, or of currency, checks, other monetary instruments, investment securities, or credit, of more than \$10,000 to a person, account, or place outside of the U.S. must be maintained. A record of each extension of credit in excess of \$2,500 and the terms and conditions of such extension of credit or repayments must be retained.

Businesses and individuals who are involved in cashing checks are required to maintain the name, address, and Social Security number of each individual for which this service is provided. In addition, records must be maintained of each check draft, money order, and cashier's check in excess of \$100. The front and back of the instrument or document must be maintained or a copy retained.

## 19.12 Terminology

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Below are terms used in money laundering activities that have special meanings. They define the particular scheme or purpose.

1. **Structuring.** When a person conducts or attempts to conduct one or more transactions in currency in any amount at one or more financial institutions on one or more days in any manner for the purpose of evading various cash-reporting requirements.
2. **Smurfing.** When a person goes to various financial institutions and makes deposits or obtains cashier's checks, money orders, traveler's checks, etc., on the same day or consecutive days.
3. **Layering.** The scheme of making financial transactions to disguise the audit trail of the illegal proceeds. This involves converting cash into monetary instruments, i.e., cashier's checks, money orders, traveler's checks, stocks, bonds, etc. Layering encompasses making multiple deposits and wire transfers or purchasing expensive assets.
4. **Integration.** The money launderer needs to provide an explanation for his wealth that appears to be legitimate. Integration is the process of routing money into the banking system to make it appear that it comes from normal business earnings. Using front companies, sham loans, and false export–import invoices commonly does this. Money launderers will purchase property at high cost with partial payment (down payment) made in cash. The purchase documents are prepared show-



ing a lower price by excluding the down payment or under-the-table payments. Overvaluation of exports is used to justify deposits as funds from foreign sources.

### 19.13 Know Your Customer

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The Federal Reserve Board issued a booklet, *Know Your Customer: Internal Compliance and Check Lists to Identify Abuses*, to help financial institutions guard against illegal activities that could cause heavy penalties and bad publicity. It advises financial institutions to be aware of unusual banking practices that are not consistent with the customer's business. Financial institutions must verify new customers' identities and true ownership of accounts. Internal controls must be maintained to ensure compliance and detection. This guidebook gives the following danger signs of money laundering activities:

1. Large number of cash deposits while balance remains low and constant.
2. Large volume of cashier's checks, money orders, or traveler's checks sold for cash.
3. Large number of cash deposits to more than one account with transfers to a single account.
4. Large cash deposits from a business that is not normally a cash business.
5. CTRs are incorrect or lack important information.
6. Transactions with offshore banks in tax haven countries.
7. Loans or investments to offshore companies.
8. Offshore banks or companies are shell companies, meaning they no physical location.
9. Frequent wire transfers to tax haven countries, especially to the same person or corporation.
10. Prepayment of interest on accounts used as collateral on loans.
11. Merchants structure credit card purchases to avoid the need for approval.
12. Purpose of loan is not recorded on the loan proceeds, or loan is used for purposes not intended.
13. Loan proceeds are sent offshore.
14. Loan proceeds are used to purchase certificates of deposits, or certificates of deposits are used for loans.
15. Customer requests to be placed on the bank's exemption list.
16. Safe deposit box has heavy traffic.
17. Cash deposits are made at the same time the safe deposit box is accessed.

### 19.14 Summary

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The federal government, as well as some states, has many laws and regulations and requires the reporting of various kinds of financial transactions by various businesses and institutions. Some businesses are well aware of these laws, regulations, and reporting forms, while others are not. Many financial institutions and businesses have been fined for noncompliance. The fraud examiner should also become familiar with the laws, regulations, and forms. This is one area that fraud examiners are most often called upon to unravel.


FINCEN Form <b>104</b> (Formerly Form 4789) (Rev. August 2003) Department of the Treasury FinCEN	<b>Currency Transaction Report</b> ▶ Previous editions will not be accepted after August 31, 2004. ▶ Please type or print. (Complete all parts that apply--See Instructions)	 OMB No. 1506-0004
1 Check all box(es) that apply:    a <input type="checkbox"/> Amends prior report    b <input type="checkbox"/> Multiple persons    c <input type="checkbox"/> Multiple transactions		
<b>Part I Person(s) Involved in Transaction(s)</b>		
<b>Section A--Person(s) on Whose Behalf Transaction(s) Is Conducted</b>		
2 Individual's last name or entity's name		3 First name
4 Middle initial		
5 Doing business as (DBA)		6 SSN or EIN 
7 Address (number, street, and apt. or suite no.)		8 Date of birth                     MM DD YYYY
9 City	10 State 	11 ZIP code 
		12 Country code (If not U.S.) 
13 Occupation, profession, or business		
14 If an individual, describe method used to verify identity:    a <input type="checkbox"/> Driver's license/State I.D.    b <input type="checkbox"/> Passport    c <input type="checkbox"/> Alien registration		
d <input type="checkbox"/> Other _____    e Issued by: _____    f Number: _____		
<b>Section B--Individual(s) Conducting Transaction(s) (if other than above).</b>		
If Section B is left blank or incomplete, check the box(es) below to indicate the reason(s)		
a <input type="checkbox"/> Armored Car Service    b <input type="checkbox"/> Mail Deposit or Shipment    c <input type="checkbox"/> Night Deposit or Automated Teller Machine    d <input type="checkbox"/> Multiple Transactions    e <input type="checkbox"/> Conducted On Own Behalf		
15 Individual's last name		16 First name
17 Middle initial		
18 Address (number, street, and apt. or suite no.)		19 SSN 
20 City	21 State 	22 ZIP code 
		23 Country code (If not U.S.) 
24 Date of birth                     MM DD YYYY		
25 If an individual, describe method used to verify identity:    a <input type="checkbox"/> Driver's license/State I.D.    b <input type="checkbox"/> Passport    c <input type="checkbox"/> Alien registration		
d <input type="checkbox"/> Other _____    e Issued by: _____    f Number: _____		
<b>Part II Amount and Type of Transaction(s). Check all boxes that apply.</b>		
26 Total cash in \$ _____ .00		27 Total cash out \$ _____ .00
28 Date of transaction                     MM DD YYYY		
26a Foreign cash in _____ .00 <small>(see instructions, page 3)</small>		27a Foreign cash out _____ .00 <small>(see instructions, page 3)</small>
29 <input type="checkbox"/> Foreign Country _____	30 <input type="checkbox"/> Wire Transfer(s)	31 <input type="checkbox"/> Negotiable Instrument(s) Purchased
32 <input type="checkbox"/> Negotiable Instrument(s) Cashed	33 <input type="checkbox"/> Currency Exchange(s)	34 <input type="checkbox"/> Deposit(s)/Withdrawal(s)
35 <input type="checkbox"/> Account Number(s) Affected (if any): _____ _____ _____	36 <input type="checkbox"/> Other (specify) _____ _____ _____	
<b>Part III Financial Institution Where Transaction(s) Takes Place</b>		
37 Name of financial institution		Enter Regulator or BSA Examiner code number (see instructions) ▶
38 Address (number, street, and apt. or suite no.)		39 EIN or SSN 
40 City	41 State 	42 ZIP code 
43 Routing (MICR) number 		
<b>Sign Here ▶</b>	44 Title of approving official	45 Signature of approving official
	46 Date of signature                     MM DD YYYY	
	47 Type or print preparer's name	48 Type or print name of person to contact
49 Telephone number ( (       )		
▶ For Paperwork Reduction Act Notice, see page 4.                      Cat. No. 42004W                      FinCEN Form 104 (Formerly Form 4789) (Rev. 8-03)		

Exhibit 19.1 Form 104 (formerly 4789), Currency Transaction Report.

FinCEN Form 104 (formerly Form 4789) (Rev. 8-03) Page 2

### Multiple Persons

Complete applicable parts below if box 1b on page 1 is checked

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**Part I Person(s) Involved in Transaction(s)**

**Section A--Person(s) on Whose Behalf Transaction(s) Is Conducted**

2 Individual's last name or entity's name		3 First name		4 Middle initial	
5 Doing business as (DBA)				6 SSN or EIN 	
7 Address (number, street, and apt. or suite no.)				8 Date of birth     /   /     MM DD YYYY	
9 City	10 State 	11 ZIP code 	12 Country code (if not U.S.) 	13 Occupation, profession, or business	
14 If an individual, describe method used to verify identity: a <input type="checkbox"/> Driver's license/State I.D. b <input type="checkbox"/> Passport c <input type="checkbox"/> Alien registration d <input type="checkbox"/> Other _____ e Issued by: _____ f Number: _____					

**Section B--Individual(s) Conducting Transaction(s) (if other than above).**

15 Individual's last name		16 First name		17 Middle initial	
18 Address (number, street, and apt. or suite no.)				19 SSN 	
20 City	21 State 	22 ZIP code 	23 Country code (if not U.S.) 	24 Date of birth     /   /     MM DD YYYY	
25 If an individual, describe method used to verify identity: a <input type="checkbox"/> Driver's license/State I.D. b <input type="checkbox"/> Passport c <input type="checkbox"/> Alien registration d <input type="checkbox"/> Other _____ e Issued by: _____ f Number: _____					

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**Part I Person(s) Involved in Transaction(s)**

**Section A--Person(s) on Whose Behalf Transaction(s) Is Conducted**

2 Individual's last name or entity's name		3 First name		4 Middle initial	
5 Doing business as (DBA)				6 SSN or EIN 	
7 Address (number, street, and apt. or suite no.)				8 Date of birth     /   /     MM DD YYYY	
9 City	10 State 	11 ZIP code 	12 Country code (if not U.S.) 	13 Occupation, profession, or business	
14 If an individual, describe method used to verify identity: a <input type="checkbox"/> Driver's license/State I.D. b <input type="checkbox"/> Passport c <input type="checkbox"/> Alien registration d <input type="checkbox"/> Other _____ e Issued by: _____ f Number: _____					

**Section B--Individual(s) Conducting Transaction(s) (if other than above).**

15 Individual's last name		16 First name		17 Middle initial	
18 Address (number, street, and apt. or suite no.)				19 SSN 	
20 City	21 State 	22 ZIP code 	23 Country code (if not U.S.) 	24 Date of birth     /   /     MM DD YYYY	
25 If an individual, describe method used to verify identity: a <input type="checkbox"/> Driver's license/State I.D. b <input type="checkbox"/> Passport c <input type="checkbox"/> Alien registration d <input type="checkbox"/> Other _____ e Issued by: _____ f Number: _____					

Exhibit 19.1 (continued)

**Suspicious Transactions**

This Currency Transaction Report (CTR) should NOT be filed for suspicious transactions involving \$10,000 or less in currency OR to note that a transaction of more than \$10,000 is suspicious. Any suspicious or unusual activity should be reported by a financial institution in the manner prescribed by its appropriate federal regulator or BSA examiner. (See the instructions for Item 3.7) If a transaction is suspicious and in excess of \$10,000 in currency, then both a CTR and the appropriate Suspicious Activity Report form must be filed.

Should the suspicious activity require immediate attention, financial institutions should telephone 1-800-800-CTRS. An Internal Revenue Service (IRS) employee will direct the call to the local office of the IRS Criminal Investigation Division (CI). This toll-free number is operational Monday through Friday, from approximately 9:00 am to 6:00 pm Eastern Standard Time. If an emergency, consult directory assistance for the local IRS CID Office.

**General Instructions**

**Who Must File.** Each financial institution (other than a casino, which instead must file FinCEN Form 103, and the U.S. Postal Service for which there are separate rules) must file FinCEN Form 104 (formerly 4789) (CTR) for each deposit, withdrawal, exchange of currency, or other payment or transfer, by, through, or to the financial institution which involves a transaction in currency of more than \$10,000. Multiple transactions must be treated as a single transaction if the financial institution has knowledge that (1) they are by or on behalf of the same person, and (2) they result in either currency received (Cash In) or currency disbursed (Cash Out) by the financial institution totaling more than \$10,000 during any one business day. For a bank, a business day is the day on which transactions are routinely posted to customers' accounts, as normally communicated to depository customers. For all other financial institutions, a business day is a calendar day.

Generally, financial institutions are defined as banks, other types of depository institutions, brokers or dealers in securities, money transmitters, currency exchangers, check cashers, and issuers and sellers of money orders and traveler's checks. Should you have questions, see the definitions in 31 CFR Part 103.

**When and Where To File.** File this CTR by the 15th calendar day after the day of the transaction with the:

IRS Detroit Computing Center  
ATTN: CTR  
PO. Box 33604  
Detroit, MI 48232-5604

Keep a copy of each CTR for five years from the date filed.

A financial institution may apply to file the CTRs magnetically. To obtain an application to file magnetically, write to the:

IRS Detroit Computing Center  
ATTN: CTR Magnetic Media Coordinator  
PO. Box 33604  
Detroit, MI 48232-5604

**Identification Requirements.** All individuals (except employees of armored car services) conducting a reportable transaction(s) for themselves or for another person, must be identified by means of an official document(s). Acceptable forms of identification include a driver's license, military and military/dependent identification cards, passport, state issued identification card, cedular card (foreign), non-resident alien identification cards, or any other identification document

or documents, which contain name and preferably address and a photograph and are normally acceptable by financial institutions as a means of identification when cashing checks for persons other than established customers.

Acceptable identification information obtained previously and maintained in the financial institution's records may be used. For example, if documents verifying an individual's identity were examined and recorded on a signature card when an account was opened, the financial institution may rely on that information. In completing the CTR, the financial institution must indicate on the form the method, type, and number of the identification. Statements such as "known customer" or "signature card on file" are not sufficient for form completion.

**Penalties.** Civil and criminal penalties are provided for failure to file a CTR or to supply information or for filing a false or fraudulent CTR. See 31 U.S.C. 5321, 5322 and 5324.

**For purposes of this CTR, the terms below have the following meanings:**

**Currency.** The coin and paper money of the United States or any other country, which is circulated and customarily used and accepted as money.

**Person.** An individual, corporation, partnership, trust or estate, joint stock company, association, syndicate, joint venture or other unincorporated organization or group.

**Organization.** Entity other than an individual.

**Transaction in Currency.** The physical transfer of currency from one person to another. This does not include a transfer of funds by means of bank check, bank draft, wire transfer or other written order that does not involve the physical transfer of currency.

**Negotiable Instruments.** All checks and drafts (including business, personal, bank, cashier's and third-party), money orders, and promissory notes. For purposes of this CTR, all traveler's checks shall also be considered negotiable instruments whether or not they are in bearer form.

**Foreign exchange rates.** If completing items 26a/27a, use the exchange rate in effect for the business day of the transaction. The source of the exchange rate that is used will be determined by the reporting institution.

**Specific Instructions**  
Because of the limited space on the front and back of the CTR, it may be necessary to submit additional information on attached sheets. Submit this additional information on plain paper attached to the CTR. Be sure to put the individual's or entity's name and identifying number (items 2, 3, 4, and 6 of the CTR) on any additional sheets so that if it becomes separated, it may be associated with the CTR.

**Item 1a. Amends Prior Report.** If this CTR is being filed because it amends a report filed previously, check Item 1a. Staple a copy of the original CTR to the amended one, complete Part III fully and only those other entries which are being amended.

**Item 1b. Multiple Persons.** If this transaction is being conducted by more than one person or on behalf of more than one person, check Item 1b. Enter information in Part I for one of the persons and provide information on any other persons on the back of the CTR.

**Item 1c. Multiple Transactions.** If the financial institution has knowledge that there are multiple transactions, check Item 1c.

**PART I - Person(s) Involved in Transaction(s)**

Section A must be completed. If an individual conducts a transaction on his own behalf, complete Section A and leave Section "B" BLANK. If an individual conducts a transaction on his own behalf and on behalf of another person(s), complete Section "A" for each person and leave Section "B" BLANK. If an individual conducts a transaction on behalf of another person(s), complete Section "B" for the individual conducting the transaction, and complete Section "A" for each person on whose behalf the transaction is conducted of whom the financial institution has knowledge.

**Section A. Person(s) on Whose Behalf Transaction(s) Is Conducted.** See instructions above.

**Items 2, 3, and 4. Individual/Organization Name.** If the person on whose behalf the transaction(s) is conducted is an individual, put his/her last name in Item 2, first name in Item 3, and middle initial in Item 4. If there is no middle initial, leave item 4 BLANK. If the transaction is conducted on behalf of an entity, put its name in Item 2 and leave Items 3 and 4 BLANK.

**Item 5. Doing Business As (DBA).** If the financial institution has knowledge of a separate "doing business as" name, enter it in Item 5. For example, Smith Enterprise DBA Mj's Pizzeria.

**Item 6. SSN/ITIN or EIN.** Enter the Social Security Number (SSN) or Individual Taxpayer Identification Number (ITIN) or Employer Identification Number (EIN) of the person or entity identified in Item 2. If none, write NONE.

**Items 7, 9, 10, 11, and 12. Address.** Enter the permanent address including ZIP Code of the person identified in Item 2. Use the U.S. Postal Service's two letter state abbreviation code. A P.O. Box should not be used by itself, and may only be used if there is no street address. If a P.O. Box is used, the name of the apartment or suite number, road or route number where the person resides must also be provided. If the address is outside the U.S., provide the street address, city, province or state, postal code (if known), and the two letter country code. For country code list go to [www.fincen.gov/reg\\_bsaforms.html](http://www.fincen.gov/reg_bsaforms.html) or telephone 1-800-949-2732 and select option number 5. If U.S., leave item 12 blank.

**Item 8. Date of Birth.** Enter the date of birth. Eight numerals must be inserted for each date. The first two will reflect the month, the second two the day, and the last four the year. A zero (0) should precede any single digit number. For example, if an individual's birth date is April 3 1948, Item 8 should read 04 03 1948.

**Item 13. Occupation, Profession, or Business.** Identify the occupation, profession, or business of the person on whose behalf the transaction was conducted. For example: secretary, shoe salesman, carpenter, attorney, housewife, restaurant, liquor store, etc. Do not use non-specific terms such as merchant, self-employed, businessman, etc.

**Item 14. If an Individual, Describe Method Used To Verify Identity.** If an individual conducts the transaction(s) on his/her own behalf, his/her identity must be verified by examination of an acceptable document (see General Instructions). For example, check box a if a driver's license is used to verify an individual's identity, and enter the state that issued the license and the number in items e and f. If the transaction is conducted by an individual on behalf of another individual not present or on behalf of an entity, enter N/A in Item 14.

**Section B. Individual(s) Conducting Transaction(s) (f other than above).** Financial institutions should enter as much information as is available.

However, there may be instances in which Items 15-25 may be left BLANK or incomplete. If Items 15-25 are left BLANK or incomplete, check one or more of the boxes provided to indicate the reasons.

Example: If there are multiple transactions that, if only when aggregated, the financial institution has knowledge the transactions exceed the reporting threshold, and therefore, did not identify the transaction(s), check box d for Multiple Transactions.

Items 15, 16, and 17. Individual's Name. Complete these items if an individual conducts a transaction(s) on behalf of another person. For example, if John Doe, an employee of XYZ Grocery Store, makes a deposit to the store's account, XYZ Grocery Store should be identified in Section A and John Doe should be identified in section B.

Items 18, 20, 21, 22, and 23. Address. Enter the permanent street address including ZIP Code of the individual. (See the instructions for Items 7 and 9 through 12.) Enter country code if not U.S. (Reference item 12).

Item 19. SSN/ITIN. If the individual has a Social Security Number, or Individual Taxpayer Identification Number, enter it in Item 19. If the individual does not have an SSN/ITIN, enter NONE.

Item 24. Date of Birth. Enter the individual's date of birth. (See the instructions for Item 8.)

Item 25. If an Individual, Describe Method Used To Verify Identity. Enter the method used to identify the individual's identity. (See General Instructions and the instructions for Item 14.)

PART II - Amount and Type of Transaction(s) Complete Part II to identify the type of transaction(s) and the amount(s) involved.

Items 26 and 27. Total Cash In/Total Cash Out. In the spaces provided, enter the total amount of currency received (Total Cash In) or total currency disbursed (Total Cash Out) by the financial institution. If foreign currency is exchanged, use the U.S. dollar equivalent on the day of the transaction (See "Foreign exchange rates"), and complete item 26a or 27a, whichever is appropriate.

If less than a full dollar amount is involved, increase that figure to the next highest dollar. For example, if the currency totals \$20,000.05, show the total as \$20,001.00.

Items 26a and 27a. Foreign cash in/Foreign cash out. If foreign currency is exchanged, enter the amount of foreign currency in items 26a and 27a. Report country of origin in item 29.

Item 28. Date of Transaction. Insert eight numerals for each date. (See instructions for Item 8.)

Item 29. Foreign Currency. If items 26a and/or 27a are completed indicating that foreign currency is involved, check item 29 and identify the country. If multiple foreign currencies are involved, check box 36 and identify the additional country(s) and/or currency(s) involved.

Determining Whether Transactions Meet the Reporting Threshold.

Only cash transactions that, if alone or when aggregated, exceed \$10,000 should be reported on the CTR. Transactions shall not be offset against one another.

If there are both Cash In and Cash Out transactions that are reportable, the amounts should be considered separately and not aggregated. However, they may be reported on a single CTR.

If there is a currency exchange, it should be aggregated separately with each of the Cash In and Cash Out totals.

Example 1: A person deposits \$11,000 in currency to his savings account and withdraws \$3,000 in currency from his checking account. The CTR should be completed as follows:

Cash In \$11,000 and no entry for Cash Out. This is because the \$3,000 transaction does not meet the reporting threshold.

Example 2: A person deposits \$11,000 in currency to his savings account and withdraws \$12,000 in currency from his checking account. The CTR should be completed as follows:

Cash In \$11,000, Cash Out \$12,000. This is because there are two reportable transactions. However, one CTR may be filed to reflect both.

Example 3: A person deposits \$6,000 in currency to his savings account and withdraws \$4,000 in currency from his checking account. Further, he presents \$5,000 in currency to be exchanged for the equivalent in French Francs. The CTR should be completed as follows:

Cash In \$11,000 and no entry for Cash Out. This is because in determining whether the transactions are reportable, the currency exchange is aggregated with each of the Cash In and Cash Out amounts. The result is a reportable \$11,000 Cash In transaction. The total Cash Out amount is \$9,000, which does not meet the reporting threshold. Therefore, it is not entered on the CTR.

Example 4: A person deposits \$6,000 in currency to his savings account and withdraws \$7,000 in currency from his checking account. Further, he presents \$5,000 in currency to be exchanged for the equivalent in French francs. The CTR should be completed as follows:

Cash In \$11,000, Cash Out \$12,000. This is because in determining whether the transactions are reportable, the currency exchange is aggregated with each of the Cash In and Cash Out amounts. In this example, each of the Cash In and Cash Out totals exceed \$10,000 and must be reflected on the CTR.

Items 30-33. Check the appropriate item(s) to identify the following type of transaction(s):

- 30. Wire Transfer(s)
31. Negotiable Instrument(s) Purchased
32. Negotiable Instrument(s) Cashed
33. Currency Exchange(s)

Item 34. Deposits/Withdrawals. Check this item to identify deposits to or withdrawals from accounts, e.g. demand deposit accounts, savings accounts, time deposits, mutual fund accounts, or any other account held at the financial institution. Enter the account number(s) in Item 35.

Item 35. Account Numbers Affected (if any). Enter the account numbers of any accounts affected by the transactions that are maintained at the financial institution conducting the transaction(s). If necessary, use additional sheets of paper to indicate all of the affected accounts.

Example 1: If a person cashes a check drawn on an account held at the financial institution, the CTR should be completed as follows:

Indicate negotiable instrument(s) cashed and provide the account number of the check.

If the transaction does not affect an account, make no entry.

Example 2: A person cashes a check drawn on another financial institution. In this instance, negotiable instrument(s) cashed would be indicated, but no account at the financial institution has been affected. Therefore, item 35 should be left BLANK.

Item 36. Other (specify). If a transaction is not identified in Items 30-34, check Item 36 and provide an additional description. For example, a person presents a check to purchase "foreign currency." Also list multiple foreign currencies from item 29.

PART III - Financial Institution Where Transaction(s) Take Place

Item 37. Name of Financial Institution and Identity of Regulator or BSA Examiner. Enter the financial institution's full legal name and identify the regulator or BSA examiner, using the following codes:

Table with 2 columns: Regulator or BSA Examiner, CODE. Lists various regulators like OCC, FDIC, FRS, etc.

Items 38, 40, 41, and 42. Address. Enter the street address, city, state, and ZIP Code of the financial institution where the transaction occurred. If there are multiple transactions, provide information of the office or branch where any one of the transactions has occurred.

Item 39. EIN or SSN. Enter the financial institution's EIN. If the financial institution does not have an EIN, enter the SSN of the financial institution's principal owner.

Item 43. Routing (MICR) Number. If a depository institution, enter the routing (Magnetic Ink Character Recognition (MICR)) number.

SIGNATURE

Items 44 and 45. Title and signature of Approving Official. The official who reviews and approves the CTR must indicate his/her title and sign the CTR.


Item 46. Date of Signature. The approving official must enter the date the CTR is signed. (See the instructions for Item 8.)

Item 47. Preparer's Name. Type or print the full name of the individual preparing the CTR. The preparer and the approving official may not necessarily be the same individual.

Items 48 and 49. Contact Person/Telephone Number. Type or print the name and telephone number of an individual to contact concerning questions about the CTR.

Paperwork Reduction Act Notice. The requested information is useful in criminal, tax, and regulatory investigations and proceedings. Financial institutions are required to provide the information under 31 U.S.C. 5313 and 31 CFR Part 103, commonly referred to as the Bank Secrecy Act (BSA). The BSA is administered by the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN). You are not required to provide the requested information unless a form displays a valid OMB control number.

The time needed to complete this form will vary depending on individual circumstances. The estimated average time is 19 minutes. If you have comments concerning the accuracy of this time estimate or suggestions for making this form simpler, you may write to the Financial Crimes Enforcement Network, P. O. Box 39, Vienna, VA 22183. Do not send this form to this office. Instead, see When and Where to File in the instructions.

<div style="border: 1px solid black; padding: 5px;"> <p><b>FinCEN Form 105</b> (Formerly Customs Form 4790) (Rev. July 2003) Department of the Treasury FinCEN</p> </div>		<p>DEPARTMENT OF THE TREASURY FINANCIAL CRIMES ENFORCEMENT NETWORK</p> <p><b>REPORT OF INTERNATIONAL TRANSPORTATION OF CURRENCY OR MONETARY INSTRUMENTS</b></p>	<p>OMB NO. 1506-0014</p> <div style="border: 1px solid black; padding: 5px; font-size: small;"> <p>▶ To be filed with the Bureau of Customs and Border Protection</p> <p>▶ For Paperwork Reduction Act Notice and Privacy Act Notice, see back of form.</p> </div> <p style="font-size: x-small;">31 U.S.C. 5316; 31 CFR 103.23 and 103.27</p>
<p><b>▶ Please type or print.</b></p>			
<p><b>PART I</b> FOR A PERSON DEPARTING OR ENTERING THE UNITED STATES, OR A PERSON SHIPPING, MAILING, OR RECEIVING CURRENCY OR MONETARY INSTRUMENTS. (IF ACTING FOR ANYONE ELSE, ALSO COMPLETE PART II BELOW.)</p>			
1. NAME (Last or family, first, and middle)	2. IDENTIFICATION NO. (See instructions)	3. DATE OF BIRTH (Mo./Day/Yr.)	
4. PERMANENT ADDRESS IN UNITED STATES OR ABROAD		5. YOUR COUNTRY OR COUNTRIES OF CITIZENSHIP	
6. ADDRESS WHILE IN THE UNITED STATES		7. PASSPORT NO. & COUNTRY	
8. U.S. VISA DATE (Mo./Day/Yr.)	9. PLACE UNITED STATES VISA WAS ISSUED	10. IMMIGRATION ALIEN NO.	
11. IF CURRENCY OR MONETARY INSTRUMENT IS ACCOMPANIED BY A PERSON, COMPLETE 11a OR 11b			
A. EXPORTED FROM THE UNITED STATES		B. IMPORTED INTO THE UNITED STATES	
Departed From: (U.S. Port/City in U.S.)	Arrived At: (Foreign City/Country)	Departed From: (Foreign City/Country)	Arrived At: (City in U.S.)
12. IF CURRENCY OR MONETARY INSTRUMENT WAS MAILED OR OTHERWISE SHIPPED, COMPLETE 12a THROUGH 12f			
12a. DATE SHIPPED (Mo./Day/Yr.)	12b. DATE RECEIVED (Mo./Day/Yr.)	12c. METHOD OF SHIPMENT (e.g. u.s. Mail, Public Carrier, etc.)	12d. NAME OF CARRIER
12e. SHIPPED TO (Name and Address)			
12f. RECEIVED FROM (Name and Address)			
<p><b>PART II</b> INFORMATION ABOUT PERSON(S) OR BUSINESS ON WHOSE BEHALF IMPORTATION OR EXPORTATION WAS CONDUCTED</p>			
13. NAME (Last or family, first, and middle or Business Name)			
14. PERMANENT ADDRESS IN UNITED STATES OR ABROAD			
15. TYPE OF BUSINESS ACTIVITY, OCCUPATION, OR PROFESSION			15a. IS THE BUSINESS A BANK? <input type="checkbox"/> Yes <input type="checkbox"/> No
<p><b>PART III</b> CURRENCY AND MONETARY INSTRUMENT INFORMATION (SEE INSTRUCTIONS ON REVERSE)(To be completed by everyone)</p>			
16. TYPE AND AMOUNT OF CURRENCY/MONETARY INSTRUMENTS		17. IF OTHER THAN U.S. CURRENCY IS INVOLVED, PLEASE COMPLETE BLOCKS A AND B.	
Currency and Coins	▶ \$	A. Currency Name	
Other Monetary Instruments (Specify type, issuing entity and date, and serial or other identifying number.)	▶ \$	B. Country	
(TOTAL)	▶ \$		
<p><b>PART IV</b> SIGNATURE OF PERSON COMPLETING THIS REPORT</p>			
Under penalties of perjury, I declare that I have examined this report, and to the best of my knowledge and belief it is true, correct and complete.			
18. NAME AND TITLE (Print)	19. SIGNATURE	20. DATE OF REPORT (Mo./Day/Yr.)	
<p><b>CUSTOMS AND BORDER PROTECTION USE ONLY</b></p>			
DATE		AIRLINE/FLIGHT/VESSEL	LICENSE PLATE
		STATE/COUNTRY	NUMBER
		COUNT VERIFIED Yes <input type="checkbox"/> No <input type="checkbox"/>	VOLUNTARY REPORT Yes <input type="checkbox"/> No <input type="checkbox"/>
		INSPECTOR (Name and Badge Number)	

FinCEN FORM 105  
(Formerly Customs Form 4790)

**Exhibit 19.2** Form 105 (formerly 4790), Report of International Transportation of Currency or Monetary Instruments.

**GENERAL INSTRUCTIONS**

This report is required by 31 U.S.C. 5316 and Treasury Department regulations (31 CFR 103).

**WHO MUST FILE:**

(1) Each person who physically transports, mails, or ships, or causes to be physically transported, mailed, or shipped currency or other monetary instruments in an aggregate amount exceeding \$10,000 at one time from the United States to any place outside the United States or into the United States from any place outside the United States, and

(2) Each person who receives in the United States currency or other monetary instruments in an aggregate amount exceeding \$10,000 at one time which have been transported, mailed, or shipped to the person from any place outside the United States.

**A TRANSFER OF FUNDS THROUGH NORMAL BANKING PROCEDURES, WHICH DOES NOT INVOLVE THE PHYSICAL TRANSPORTATION OF CURRENCY OR MONETARY INSTRUMENTS, IS NOT REQUIRED TO BE REPORTED.**

**Exceptions:** Reports are not required to be filed by:

- (1) a Federal Reserve bank,
- (2) a bank, a foreign bank, or a broker or dealer in securities in respect to currency or other monetary instruments mailed or shipped through the postal service or by common carrier,
- (3) a commercial bank or trust company organized under the laws of any State or of the United States with respect to overland shipments of currency or monetary instruments shipped to or received from an established customer maintaining a deposit relationship with the bank, in amounts which the bank may reasonably conclude do not exceed amounts commensurate with the customary conduct of the business, industry, or profession of the customer concerned,
- (4) a person who is not a citizen or resident of the United States in respect to currency or other monetary instruments mailed or shipped from abroad to a bank or broker or dealer in securities through the postal service or by common carrier,
- (5) a common carrier of passengers in respect to currency or other monetary instruments in the possession of its passengers,
- (6) a common carrier of goods in respect to shipments of currency or monetary instruments not declared to be such by the shipper,
- (7) a traveler's check issuer or its agent in respect to the transportation of travelers' checks prior to their delivery to selling agents for eventual sale to the public,
- (8) a person with a restrictively endorsed traveler's check that is in the collection and reconciliation process after the traveler's check has been negotiated, nor by
- (9) a person engaged as a business in the transportation of currency, monetary instruments and other commercial papers with respect to the transportation of currency or other monetary instruments overland between established offices of banks or brokers or dealers in securities and foreign persons.

**WHEN AND WHERE TO FILE:**

**A. Recipients**—Each person who receives currency or other monetary instruments in the United States shall file FinCEN Form 105, within 15 days after receipt of the currency or monetary instruments, with the Customs officer in charge at any port of entry or departure or by mail with the **Commissioner of Customs, Attention: Currency Transportation Reports, Washington DC 20229.**

**B. Shippers or Mailers**—If the currency or other monetary instrument does not accompany the person entering or departing the United States, FinCEN Form 105 may be filed by mail on or before the date of entry, departure, mailing, or shipping with the **Commissioner of Customs, Attention: Currency Transportation Reports, Washington DC 20229.**

**C. Travelers**—Travelers carrying currency or other monetary instruments with them shall file FinCEN Form 105 at the time of entry into the United States or at the time of departure from the United States with the Customs officer in charge at any Customs port of entry or departure.

An additional report of a particular transportation, mailing, or shipping of currency or the monetary instruments is not required if a complete and truthful report has already been filed. However, no person otherwise required to file a report shall be excused from liability for failure to do so if, in fact, a complete and truthful report has not been filed. Forms may be obtained from any Bureau of Customs and Border Protection office.

**PENALTIES:** Civil and criminal penalties, including under certain circumstances a fine of not more than \$500,000 and imprisonment of not more than ten years, are provided for failure to file a report, filing a report containing a material omission or misstatement, or filing a false or fraudulent report. In addition, the currency or monetary instrument may be subject to seizure and forfeiture. See 31 U.S.C. 5321 and 31 CFR 103.57; 31 U.S.C. 5322 and 31 CFR 103.59; 31 U.S.C. 5317 and 31 CFR 103.58, and U.S.C. 5332.

**DEFINITIONS:**

**Bank**—Each agent, agency, branch or office within the United States of any person doing business in one or more of the capacities listed: (1) a commercial bank or trust company organized under the laws of any State or of the United States; (2) a private bank; (3) a savings association, savings and loan association, and building and loan association organized under the laws of any State or of the United States; (4) an insured institution as defined in section 401 of the National Housing Act; (5) a savings bank, industrial bank or other thrift institution; (6) a credit union organized under the laws of any State or of the

United States; (7) any other organization chartered under the banking laws of any State and subject to the supervision of the bank supervisory authorities of a State other than a money service business; (8) a bank organized under foreign law; and (9) any national banking association or corporation acting under the provisions of section 25A of the Federal Reserve Act (12 U.S.C. Sections 611-632).

**Foreign Bank**—A bank organized under foreign law, or an agency, branch or office located outside the United States of a bank. The term does not include an agent, agency, branch or office within the United States of a bank organized under foreign law.

**Broker or Dealer in Securities**—A broker or dealer in securities, registered or required to be registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934.

**Identification Number**—Individuals must enter their social security number, if any. However, aliens who do not have a social security number should enter passport or alien registration number. All others should enter their employer identification number.

**Monetary Instruments**—(1) Coin or currency of the United States or of any other country, (2) traveler's checks in any form, (3) negotiable instruments (including checks, promissory notes, and money orders) in bearer form, endorsed without restriction, made out to a fictitious payee, or otherwise in such form that title thereto passes upon delivery, (4) incomplete instruments (including checks, promissory notes, and money orders) that are signed but on which the name of the payee has been omitted, and (5) securities or stock in bearer form or otherwise in such form that title thereto passes upon delivery. Monetary instruments do not include (i) checks or money orders made payable to the order of a named person which have not been endorsed or which bear restrictive endorsements, (ii) warehouse receipts, or (iii) bills of lading.

**Person**—An individual, a corporation, a partnership, a trust or estate, a joint stock company, an association, a syndicate, joint venture or other unincorporated organization or group, an Indian Tribe (as that term is defined in the Indian Gaming Regulatory Act), and all entities cognizable as legal personalities.

**SPECIAL INSTRUCTIONS**

You should complete each line that applies to you. **PART II.** -Block 13; provide the complete name of the shipper or recipient on whose behalf the exportation or importation was conducted. **PART III.** — Specify type of instrument, issuing entity, and date, serial or other identifying number, and payee (if any). **PART IV.** — Block 22A and 22B; enter the exact date you shipped or received currency or monetary instrument(s). Block 21, if currency or monetary instruments of more than one country is involved, attach a list showing each type, country or origin and amount.

**PRIVACY ACT AND PAPERWORK REDUCTION ACT NOTICE:**

Pursuant to the requirements of Public law 93-579 (Privacy Act of 1974), notice is hereby given that the authority to collect information on Form 4790 in accordance with 5 U.S.C. 552a(e)(3) is Public law 91-508; 31 U.S.C. 5316; 5 U.S.C. 301; Reorganization Plan No. 1 of 1950; Treasury Department Order No. 165, revised, as amended; 31 CFR 103; and 44 U.S.C. 3501.

The principal purpose for collecting the information is to assure maintenance of reports or records having a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings. The information collected may be provided to those officers and employees of the Bureau of Customs and Border Protection and any other constituent unit of the Department of the Treasury who have a need for the records in the performance of their duties. The records may be referred to any other department or agency of the Federal Government upon the request of the head of such department or agency. The information collected may also be provided to appropriate state, local, and foreign criminal law enforcement and regulatory personnel in the performance of their official duties.

Disclosure of this information is mandatory pursuant to 31 U.S.C. 5316 and 31 CFR Part 103 (See Penalties).

Disclosure of the social security number is mandatory. The authority to collect this number is 31 U.S.C. 5316(b) and 31 CFR 103.27(d). The social security number will be used as a means to identify the individual who files the record.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number. The collection of this information is mandatory pursuant to 31 U.S.C. 5316.

Statement required by 5 CFR 1320.8(b)(3)(iii): The estimated average burden associated with this collection of information is 11 minutes per respondent or record keeper depending on individual circumstances. Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be directed to the Department of the Treasury, Financial Crimes Enforcement Network, P.O. Box 39 Vienna, Virginia 22183. **DO NOT send completed forms to this office—See When and Where To File above.**

FinCEN FORM 105  
(Formerly Customs Form 4790)

IRS Form **8300**

(Rev. December 2001)

OMB No. 1545-0892  
Department of the Treasury  
Internal Revenue Service

**Report of Cash Payments Over \$10,000  
Received in a Trade or Business**

▶ See instructions for definition of cash.

▶ Use this form for transactions occurring after December 31, 2001. Do not use prior versions after this date.  
For Privacy Act and Paperwork Reduction Act Notice, see page 4.

FinCEN **8300**

(December 2001)  
OMB No. 1506-0018  
Department of the Treasury  
Financial Crimes  
Enforcement Network

1 Check appropriate box(es) if: a  Amends prior report; b  Suspicious transaction.

**Part I Identity of Individual From Whom the Cash Was Received**

2 If more than one individual is involved, check here and see instructions ▶

3 Last name 4 First name 5 M.I. 6 Taxpayer identification number

7 Address (number, street, and apt. or suite no.) 8 Date of birth (see instructions) M M D D Y Y Y Y

9 City 10 State 11 ZIP code 12 Country (if not U.S.) 13 Occupation, profession, or business

14 Document used to verify identity: a Describe identification ▶ b Issued by c Number

**Part II Person on Whose Behalf This Transaction Was Conducted**

15 If this transaction was conducted on behalf of more than one person, check here and see instructions ▶

16 Individual's last name or Organization's name 17 First name 18 M.I. 19 Taxpayer identification number

20 Doing business as (DBA) name (see instructions) Employer identification number

21 Address (number, street, and apt. or suite no.) 22 Occupation, profession, or business

23 City 24 State 25 ZIP code 26 Country (if not U.S.)

27 Alien identification: a Describe identification ▶ b Issued by c Number

**Part III Description of Transaction and Method of Payment**

28 Date cash received M M D D Y Y Y Y 29 Total cash received \$ .00 30 If cash was received in more than one payment, check here ▶  31 Total price if different from item 29 \$ .00

32 Amount of cash received (in U.S. dollar equivalent) (must equal item 29) (see instructions):  
a U.S. currency \$ .00 (Amount in \$100 bills or higher \$ .00)  
b Foreign currency \$ .00 (Country ▶ )  
c Cashier's check(s) \$ .00 } Issuer's name(s) and serial number(s) of the monetary instrument(s) ▶  
d Money order(s) \$ .00 }  
e Bank draft(s) \$ .00 }  
f Traveler's check(s) \$ .00 }

33 Type of transaction f  Debt obligations paid 34 Specific description of property or service shown in 33.  
a  Personal property purchased g  Exchange of cash (Give serial or registration number, address, docket  
b  Real property purchased h  Escrow or trust funds number, etc.) ▶  
c  Personal services provided i  Bail received by court clerks  
d  Business services provided j  Other (specify) ▶  
e  Intangible property purchased

**Part IV Business That Received Cash**

35 Name of business that received cash 36 Employer identification number

37 Address (number, street, and apt. or suite no.) Social security number

38 City 39 State 40 ZIP code 41 Nature of your business

42 Under penalties of perjury, I declare that to the best of my knowledge the information I have furnished above is true, correct, and complete.

Signature ▶ Authorized official Title ▶

43 Date of signature M M D D Y Y Y Y 44 Type or print name of contact person 45 Contact telephone number ( )

Exhibit 19.3 Form 8300, Report of Cash Payments over \$10,000.



**Multiple Parties**

(Complete applicable parts below if box 2 or 15 on page 1 is checked)

**Part I Continued—Complete if box 2 on page 1 is checked**

3 Last name			4 First name			5 M.I.	6 Taxpayer identification number : : : : : : : : : : :							
7 Address (number, street, and apt. or suite no.)						8 Date of birth, (see instructions)	M	M	D	D	Y	Y	Y	Y
9 City			10 State :	11 ZIP code		12 Country (if not U.S.)		13 Occupation, profession, or business						
14 Document used to verify identity: a Describe identification ▶														
b Issued by						c Number								

3 Last name			4 First name			5 M.I.	6 Taxpayer identification number : : : : : : : : : : :							
7 Address (number, street, and apt. or suite no.)						8 Date of birth, (see instructions)	M	M	D	D	Y	Y	Y	Y
9 City			10 State :	11 ZIP code		12 Country (if not U.S.)		13 Occupation, profession, or business						
14 Document used to verify identity: a Describe identification ▶														
b Issued by						c Number								

**Part II Continued—Complete if box 15 on page 1 is checked**

16 Individual's last name or Organization's name						17 First name			18 M.I.	19 Taxpayer identification number : : : : : : : : : : :			
20 Doing business as (DBA) name (see instructions)									Employer identification number : : : : : : : : : : :				
21 Address (number, street, and apt. or suite no.)								22 Occupation, profession, or business					
23 City				24 State :	25 ZIP code		26 Country (if not U.S.)						
27 Alien identification: a Describe identification ▶													
b Issued by						c Number							

16 Individual's last name or Organization's name						17 First name			18 M.I.	19 Taxpayer identification number : : : : ~ : : : : ~ : : : : ~			
20 Doing business as (DBA) name (see instructions)									Employer identification number : : : : ~ : : : : ~ : : : : ~				
21 Address (number, street, and apt. or suite no.)								22 Occupation, profession, or business					
23 City				24 State :	25 ZIP code		26 Country (if not U.S.)						
27 Alien identification: a Describe identification ▶													
b Issued by						c Number							

Exhibit 19.3 (continued)

Section references are to the Internal Revenue Code unless otherwise noted.

**Changes To Note**

- Section 60501 (26 United States Code (U.S.C.) 60501) and 31 U.S.C. 5331 require that certain information be reported to the IRS and the Financial Crimes Enforcement Network (FinCEN). This information must be reported on IRS/FinCEN Form 8300.
- Item 33 box I is to be checked only by clerks of the court; box d is to be checked by bail bondsmen. See the instructions on page 4.
- For purposes of section 60501 and 31 U.S.C. 5331, the word "cash" and "currency" have the same meaning. See Cash under Definitions below.

**General Instructions**

**Who must file.** Each person engaged in a trade or business who, in the course of that trade or business, receives more than \$10,000 in cash in one transaction or in two or more related transactions, must file Form 8300. Any transactions conducted between a payer (or its agent) and the recipient in a 24-hour period are related transactions. Transactions are considered related even if they occur over a period of more than 24 hours if the recipient knows, or has reason to know, that each transaction is one of a series of connected transactions.

Keep a copy of each Form 8300 for 5 years from the date you file it.

Clerks of Federal or State courts must file Form 8300 if more than \$10,000 in cash is received as bail for an individual(s) charged with certain criminal offenses. For these purposes, a clerk includes the clerk's office or any other office, department, division, branch, or unit of the court that is authorized to receive bail. If a person receives bail on behalf of a clerk, the clerk is treated as receiving the bail. See the instructions for Item 33 on page 4.

If multiple payments are made in cash to satisfy bail and the initial payment does not exceed \$10,000, the initial payment and subsequent payments must be aggregated and the information return must be filed by the 15th day after receipt of the payment that causes the aggregate amount to exceed \$10,000 in cash. In such cases, the reporting requirement can be satisfied either by sending a single written statement with an aggregate amount listed or by furnishing a copy of each Form 8300 relating to that payer. Payments made to satisfy separate bail requirements are not required to be aggregated. See Treasury Regulations section 1.60501-2.

Casinos must file Form 8300 for nongaming activities (restaurants, shops, etc.).

**Voluntary use of Form 8300.** Form 8300 may be filed voluntarily for any suspicious transaction (see Definitions) for use by FinCEN and the IRS, even if the total amount does not exceed \$10,000.

**Exceptions.** Cash is not required to be reported if it is received:

- By a financial institution required to file Form 4789, Currency Transaction Report.
- By a casino required to file (or exempt from filing) Form 8362, Currency Transaction Report by Casinos, if the cash is received as part of its gaming business.
- By an agent who receives the cash from a principal, if the agent uses all of the cash within 15 days in a second transaction that is reportable on Form 8300 or on Form 4789, and discloses all the information necessary to complete Part II of Form 8300 or Form 4789 to the recipient of the cash in the second transaction.

- In a transaction occurring entirely outside the United States. See Pub. 1544, Reporting Cash Payments Over \$10,000 (Received in a Trade or Business), regarding transactions occurring in Puerto Rico, the Virgin Islands, and territories and possessions of the United States.

- In a transaction that is not in the course of a person's trade or business.

**When to file.** File Form 8300 by the 15th day after the date the cash was received. If that date falls on a Saturday, Sunday, or legal holiday, file the form on the next business day.

**Where to file.** File the form with the Internal Revenue Service, Detroit Computing Center, P.O. Box 32621, Detroit, MI 48232.

**Statement to be provided.** You must give a written statement to each person named on a required Form 8300 on or before January 31 of the year following the calendar year in which the cash is received. The statement must show the name, telephone number, and address of the information contact for the business, the aggregate amount of reportable cash received, and that the information was furnished to the IRS. Keep a copy of the statement for your records.

**Multiple payments.** If you receive more than one cash payment for a single transaction or for related transactions, you must report the multiple payments any time you receive a total amount that exceeds \$10,000 within any 12-month period. Submit the report within 15 days of the date you receive the payment that causes the total amount to exceed \$10,000. If more than one report is required within 15 days, you may file a combined report. File the combined report no later than the date the earliest report, if filed separately, would have to be filed.

**Taxpayer identification number (TIN).** You must furnish the correct TIN of the person or persons from whom you receive the cash and, if applicable, the person or persons on whose behalf the transaction is being conducted. You may be subject to penalties for an incorrect or missing TIN.

The TIN for an individual (including a sole proprietorship) is the individual's social security number (SSN). For certain resident aliens who are not eligible to get an SSN and nonresident aliens who are required to file tax returns, it is an IRS Individual Taxpayer Identification Number (ITIN). For other persons, including corporations, partnerships, and estates, it is the employer identification number (EIN).

If you have requested but are not able to get a TIN for one or more of the parties to a transaction within 15 days following the transaction, file the report and attach a statement explaining why the TIN is not included.

**Exception:** You are not required to provide the TIN of a person who is a nonresident alien individual or a foreign organization if that person does not have income effectively connected with the conduct of a U.S. trade or business and does not have an office or place of business, or fiscal or paying agent, in the United States. See Pub. 1544 for more information.

**Penalties.** You may be subject to penalties if you fail to file a correct and complete Form 8300 on time and you cannot show that the failure was due to reasonable cause. You may also be subject to penalties if you fail to furnish timely a correct and complete statement to each person named in a required report. A minimum penalty of \$25,000 may be imposed if the failure is due to an intentional or willful disregard of the cash reporting requirements.

Penalties may also be imposed for causing, or attempting to cause, a trade or business to fail to file a required report; for causing, or

attempting to cause, a trade or business to file a required report containing a material omission or misstatement of fact; or for structuring, or attempting to structure, transactions to avoid the reporting requirements. These violations may also be subject to criminal prosecution which, upon conviction, may result in imprisonment of up to 5 years or fines of up to \$250,000 for individuals and \$500,000 for corporations or both.

**Definitions**

**Cash.** The term "cash" means the following:

- U.S. and foreign coin and currency received in any transaction.

- A cashier's check, money order, bank draft, or traveler's check having a face amount of \$10,000 or less that is received in a designated reporting transaction (defined below), or that is received in any transaction in which the recipient knows that the instrument is being used in an attempt to avoid the reporting of the transaction under either section 60501 or 31 U.S.C. 5331.

**Note:** Cash does not include a check drawn on the payer's own account, such as a personal check, regardless of the amount.

**Designated reporting transaction.** A retail sale (or the receipt of funds by a broker or other intermediary in connection with a retail sale) of a consumer durable, a collectible, or a travel or entertainment activity.

**Retail sale.** Any sale (whether or not the sale is for resale or for any other purpose) made in the course of a trade or business if that trade or business principally consists of making sales to ultimate consumers.

**Consumer durable.** An item of tangible personal property of a type that, under ordinary usage, can reasonably be expected to remain useful for at least 1 year, and that has a sales price of more than \$10,000.

**Collectible.** Any work of art, rug, antique, metal, gem, stamp, coin, etc.

**Travel or entertainment activity.** An item of travel or entertainment that pertains to a single trip or event if the combined sales price of the item and all other items relating to the same trip or event that are sold in the same transaction (or related transactions) exceeds \$10,000.

**Exceptions.** A cashier's check, money order, bank draft, or traveler's check is not considered received in a designated reporting transaction if it constitutes the proceeds of a loan bank or if it is received as a payment on certain promissory notes, installment sales contracts, or down payment plans. See Pub. 1544 for more information.

**Person.** An individual, corporation, partnership, trust, estate, association, or company.

**Recipient.** The person receiving the cash. Each branch or other unit of a person's trade or business is considered a separate recipient unless the branch receiving the cash (or a central office linking the branches), knows or has reason to know the identity of payers making cash payments to other branches.

**Transaction.** Includes the purchase of property or services, the payment of debt, the exchange of a negotiable instrument for cash, and the receipt of cash to be held in escrow or trust. A single transaction may not be broken into multiple transactions to avoid reporting.

**Suspicious transaction.** A transaction in which it appears that a person is attempting to cause Form 8300 not to be filed, or to file a false or incomplete form. The term also includes any transaction in which there is an indication of possible illegal activity.

Figure 19.3 (continued)

## Specific Instructions

You must complete all parts. However, you may skip Part II if the individual named in Part I is conducting the transaction on his or her behalf only. For voluntary reporting of suspicious transactions, see Item 1 below.

**Item 1.** If you are amending a prior report, check box 1a. Complete the appropriate items with the correct or amended information only. Complete all of Part IV. Staple a copy of the original report to the amended report.

To voluntarily report a suspicious transaction (see **Definitions**), check box 1b. You may also telephone your local IRS Criminal Investigation Division or call 1-800-800-2877.

### Part I

**Item 2.** If two or more individuals conducted the transaction you are reporting, check the box and complete Part I for any one of the individuals. Provide the same information for the other individual(s) on the back of the form. If more than three individuals are involved, provide the same information on additional sheets of paper and attach them to this form.

**Item 6.** Enter the taxpayer identification number (TIN) of the individual named. See **Taxpayer identification number (TIN)** on page 3 for more information.

**Item 8.** Enter eight numerals for the date of birth of the individual named. For example, if the individual's birth date is July 6, 1960, enter 07 06 1960.

**Item 13.** Fully describe the nature of the occupation, profession, or business (for example, "plumber," "attorney," or "automobile dealer"). Do not use general or nondescriptive terms such as "businessman" or "self-employed."

**Item 14.** You must verify the name and address of the named individual(s). Verification must be made by examination of a document normally accepted as a means of identification when cashing checks (for example, a driver's license, passport, alien registration card, or other official document). In item 14a, enter the type of document examined. In item 14b, identify the issuer of the document. In item 14c, enter the document's number. For example, if the individual has a Utah driver's license, enter "driver's license" in item 14a, "Utah" in item 14b, and the number appearing on the license in item 14c.

### Part II

**Item 15.** If the transaction is being conducted on behalf of more than one person (including husband and wife or parent and child), check the box and complete Part II for any one of the persons. Provide the same information for the other person(s) on the back of the form. If more than three persons are involved, provide the same information on additional sheets of paper and attach them to this form.

**Items 16 through 19.** If the person on whose behalf the transaction is being conducted is an individual, complete items 16, 17, and 18. Enter his or her TIN in item 19. If the individual is a sole proprietor and has an employer identification number (EIN), you must enter both the SSN and EIN in item 19. If the person is an organization, put its name as shown on required tax filings in item 16 and its EIN in item 19.

**Item 20.** If a sole proprietor or organization named in items 16 through 18 is doing business under a name other than that entered in item 16 (e.g., a "trade" or "doing business as (DBA)" name), enter it here.

**Item 27.** If the person is not required to furnish a TIN, complete this item. See **Taxpayer Identification Number (TIN)** on page 3. Enter a

description of the type of official document issued to that person in item 27a (for example, "passport"), the country that issued the document in item 27b, and the document's number in item 27c.

### Part III

**Item 28.** Enter the date you received the cash. If you received the cash in more than one payment, enter the date you received the payment that caused the combined amount to exceed \$10,000. See **Multiple payments** under **General Instructions** for more information.

**Item 30.** Check this box if the amount shown in item 29 was received in more than one payment (for example, as installment payments or payments on related transactions).

**Item 31.** Enter the total price of the property, services, amount of cash exchanged, etc. (for example, the total cost of a vehicle purchased, cost of catering service, exchange of currency) if different from the amount shown in item 29.

**Item 32.** Enter the dollar amount of each form of cash received. Show foreign currency amounts in U.S. dollar equivalent at a fair market rate of exchange available to the public. **The sum of the amounts must equal item 29.** For cashier's check, money order, bank draft, or traveler's check, provide the name of the issuer and the serial number of each instrument. Names of all issuers and all serial numbers involved must be provided. If necessary, provide this information on additional sheets of paper and attach them to this form.

**Item 33.** Check the appropriate box(es) that describe the transaction. If the transaction is not specified in boxes a-l, check box j and briefly describe the transaction (for example, "car lease," "boat lease," "house lease," or "aircraft rental"). If the transaction relates to the receipt of bail by a court clerk, check box l, "Bail received by court clerks." This box is only for use by court clerks. If the transaction relates to cash received by a bail bondsman, check box d, "Business services provided."

### Part IV

**Item 36.** If you are a sole proprietorship, you must enter your SSN. If your business also has an EIN, you must provide the EIN as well. All other business entities must enter an EIN.

**Item 41.** Fully describe the nature of your business, for example, "attorney" or "jewelry dealer." Do not use general or nondescriptive terms such as "business" or "store."

**Item 42.** This form must be signed by an individual who has been authorized to do so for the business that received the cash.

**Privacy Act and Paperwork Reduction Act Notice.** Except as otherwise noted, the information solicited on this form is required by the Internal Revenue Service (IRS) and the Financial Crimes Enforcement Network (FinCEN) in order to carry out the laws and regulations of the United States Department of the Treasury. Trades or businesses, except for clerks of criminal courts, are required to provide the information to the IRS and FinCEN under both section 6050l and 31 U.S.C. 5331. Clerks of criminal courts are required to provide the information to the IRS under section 6050l. Section 6109 and 31 U.S.C. 5331 require that you provide your social security number in order to adequately identify you and process your return and other papers. The principal purpose for collecting the information on this form is to maintain reports or records where such reports or records have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings, or in the conduct of intelligence or

counterintelligence activities, by directing the Federal Government's attention to unusual or questionable transactions.

While such information is invaluable with regards to the purpose of this form, you are not required to provide information as to whether the reported transaction is deemed suspicious. No penalties or fines will be assessed for failure to provide such information, even if you determine that the reported transaction is indeed suspicious in nature. Failure to provide all other requested information, or the provision of fraudulent information, may result in criminal prosecution and other penalties under Title 26 and Title 31 of the United States Code.


Generally, tax returns and return information are confidential, as stated in section 6103. However, section 6103 allows or requires the IRS to disclose or give the information requested on this form to others as described in the Code. For example, we may disclose your tax information to the Department of Justice, to enforce the tax laws, both civil and criminal, and to cities, states, the District of Columbia, U.S. commonwealths or possessions, and certain foreign governments to carry out their tax laws. We may disclose your tax information to the Department of Treasury and contractors for tax administration purposes; and to other persons as necessary to obtain information which we cannot get in any other way in order to determine the amount of or to collect the tax you owe. We may disclose your tax information to the Comptroller General of the United States to permit the Comptroller General to review the IRS. We may disclose your tax information to Committees of Congress; Federal, state, and local child support agencies; and to other Federal agencies for the purposes of determining entitlement for benefits or the eligibility for and the repayment of loans. We may also disclose this information to Federal agencies that investigate or respond to acts or threats of terrorism or participate in intelligence or counterintelligence activities concerning terrorism.

FinCEN may provide the information collected through this form to those officers and employees of the Department of the Treasury who have a need for the records in the performance of their duties. FinCEN may also refer the records to any other department or agency of the Federal Government upon the request of the head of such department or agency and may also provide the records to appropriate state, local, and foreign criminal law enforcement and regulatory personnel in the performance of their official duties.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any law under Title 26 or Title 31.

The time needed to complete this form will vary depending on individual circumstances. The estimated average time is 21 minutes. If you have comments concerning the accuracy of this time estimate or suggestions for making this form simpler, you can write to the Tax Forms Committee, Western Area Distribution Center, Rancho Cordova, CA 95743-0001. Do not send this form to this office. Instead, see **Where To File** on page 3.



Department of the Treasury <b>TD F 90-22.1</b> (Rev. 7/00) SUPERSEDES ALL PREVIOUS EDITIONS		<b>REPORT OF FOREIGN BANK AND FINANCIAL ACCOUNTS</b> Do <b>NOT</b> file with your Federal Tax Return			<b>1</b>
1 Filing for Calendar Year Y   Y   Y   Y		2 Type of Filer a <input type="checkbox"/> Individual    b <input type="checkbox"/> Partnership    c <input type="checkbox"/> Corporation    d <input type="checkbox"/> Fiduciary		3 Taxpayer Identification Number 	
<b>Part I Filer Information</b>					
4 Last Name or Organization Name		5 First Name		6 Middle Initial	
7 Address (Number, Street, and Apt. or Suite No.)				8 Date of Birth M   M   D   D   Y   Y   Y   Y	
9 City	10 State	11 Zip/Postal Code	12 Country	13 Title (Not necessary if reporting a personal account.)	
14 Are these accounts jointly owned? a <input type="checkbox"/> Yes    b <input type="checkbox"/> No		15 Number of joint owners	16 Taxpayer Identification Number of joint owner (if known)		
17 Last Name or Organization Name		18 First Name		19 Middle Initial	
<b>Part II Information on Financial Accounts</b>					
20 Number of Foreign Financial Accounts in which a financial interest is held		21 Type of account a <input type="checkbox"/> Bank    b <input type="checkbox"/> Securities    c <input type="checkbox"/> Other _____			
22 Maximum value of account a <input type="checkbox"/> Under \$10,000    c <input type="checkbox"/> \$100,000 to \$1,000,000 b <input type="checkbox"/> \$10,000 to \$99,999    d <input type="checkbox"/> Over \$1,000,000		23 Account Number or other designation 			
24 Name of Financial Institution with which account is held		25 Country in which account is held			
26 Does the filer have a financial interest in this account? a <input type="checkbox"/> Yes    b <input type="checkbox"/> No    If no, complete boxes 27-35.		27 Last Name or Organization Name of Account Holder			
28 First Name		29 Middle Initial		30 Taxpayer Identification Number 	
31 Address (Number, Street, and Apt. or Suite No.)				32 City	
33 State	34 Zip/Postal Code	35 Country			
36 Signature				37 Date M   M   D   D   Y   Y   Y   Y	

This form should be used to report a financial interest in, signature authority, or other authority over one or more financial accounts in foreign countries, as required by the Department of the Treasury Regulations (31 CFR 103). No report is required if the aggregate value of the accounts did not exceed \$10,000. SEE INSTRUCTIONS FOR DEFINITION. File this form with:

**U.S. Department of the Treasury, P.O. Box 32621, Detroit, MI 48232-0621.**

**PRIVACY ACT NOTIFICATION**

Pursuant to the requirements of Public Law 93-579 (Privacy Act of 1974), notice is hereby given that the authority to collect information on TD F 90-22.1 in accordance with 5 USC 522a(e) is Public Law 91-508; 31 USC 5314; 5 USC 301; 31 CFR 103.

The principal purpose for collecting the information is to assure maintenance of reports where such reports or records have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings. The information collected may be provided to those officers and employees of any constituent unit of the Department of the Treasury who have a need for the records in the performance of their duties. The records may be referred to any other department or agency of the United States upon the request of the head of such department or agency for use in a criminal, tax, or regulatory investigation or proceeding. The information collected may also be provided to appropriate state, local, and foreign law enforcement and regulatory personnel in the performance of their official duties.

Disclosure of this information is mandatory. Civil and criminal penalties, including in certain circumstances a fine of not more than \$500,000 and imprisonment of not more than five years, are provided for failure to file a report, supply information, and for filing a false or fraudulent report. Disclosure of the Social Security number is mandatory. The authority to collect is 31 CFR 103. The Social Security number will be used as a means to identify the individual who files the report.

**Exhibit 19.4** Form TDF 90-22.1, Report of Foreign Bank and Financial Accounts.

<b>Continuation Page</b>		Form TD F 90-22.1							
This side can be copied as many times as necessary in order to provide information on all accounts.									
1 Filing for Calendar Year Y   Y   Y   Y		3 Taxpayer Identification Number			4 Filer Last Name or Business Name		Page Number OF		
2 Type of Filer a <input type="checkbox"/> Individual    c <input type="checkbox"/> Corporation b <input type="checkbox"/> Partnership    d <input type="checkbox"/> Fiduciary		21 Type of Account a <input type="checkbox"/> Bank    c <input type="checkbox"/> Other b <input type="checkbox"/> Securities			22 Maximum value of account a <input type="checkbox"/> Under \$10,000    c <input type="checkbox"/> \$100,000 to \$1,000,000 b <input type="checkbox"/> \$10,000 to \$99,999    d <input type="checkbox"/> Over \$1,000,000				
23 Account Number, or other designation				24 Name of Financial Institution with which account is held					
25 Country in which account is held		26 Does the filer have a financial interest in this account? a <input type="checkbox"/> Yes If no, complete boxes 27-35.    b <input type="checkbox"/> No		27 Last Name or Organization Name of Account Owner					
28 First Name		29 Middle Initial	30 Taxpayer Identification Number		31 Address (Number, Street, and Apt. or Suite No.)				
32 City		33 State	34 Zip/Postal Code		35 Country				

2 Type of Filer a <input type="checkbox"/> Individual    c <input type="checkbox"/> Corporation b <input type="checkbox"/> Partnership    d <input type="checkbox"/> Fiduciary		21 Type of Account a <input type="checkbox"/> Bank    c <input type="checkbox"/> Other b <input type="checkbox"/> Securities			22 Maximum value of account a <input type="checkbox"/> Under \$10,000    c <input type="checkbox"/> \$100,000 to \$1,000,000 b <input type="checkbox"/> \$10,000 to \$99,999    d <input type="checkbox"/> Over \$1,000,000				
23 Account Number, or other designation				24 Name of Financial Institution with which account is held					
25 Country in which account is held		26 Does the filer have a financial interest in this account? a <input type="checkbox"/> Yes If no, complete boxes 27-35.    b <input type="checkbox"/> No		27 Last Name or Organization Name of Account Owner					
28 First Name		29 Middle Initial	30 Taxpayer Identification Number		31 Address (Number, Street, and Apt. or Suite No.)				
32 City		33 State	34 Zip/Postal Code		35 Country				

2 Type of Filer a <input type="checkbox"/> Individual    c <input type="checkbox"/> Corporation b <input type="checkbox"/> Partnership    d <input type="checkbox"/> Fiduciary		21 Type of Account a <input type="checkbox"/> Bank    c <input type="checkbox"/> Other b <input type="checkbox"/> Securities			22 Maximum value of account a <input type="checkbox"/> Under \$10,000    c <input type="checkbox"/> \$100,000 to \$1,000,000 b <input type="checkbox"/> \$10,000 to \$99,999    d <input type="checkbox"/> Over \$1,000,000				
23 Account Number, or other designation				24 Name of Financial Institution with which account is held					
25 Country in which account is held		26 Does the filer have a financial interest in this account? a <input type="checkbox"/> Yes If no, complete boxes 27-35.    b <input type="checkbox"/> No		27 Last Name or Organization Name of Account Owner					
28 First Name		29 Middle Initial	30 Taxpayer Identification Number		31 Address (Number, Street, and Apt. or Suite No.)				
32 City		33 State	34 Zip/Postal Code		35 Country				

This form should be used to report a financial interest in, signature authority, or other authority over one or more financial accounts in foreign countries, as required by the Department of the Treasury Regulations (31 CFR 103). No report is required if the aggregate value of the accounts did not exceed \$10,000. SEE INSTRUCTIONS FOR DEFINITION. File this form with:

**U.S. Department of the Treasury, P.O. Box 32621, Detroit, MI 48232-0621.**

**Paperwork Reduction Act.** The estimated average burden associated with this collection of information is 10 minutes per respondent or recordkeeper, depending on individual circumstances. Comments regarding the accuracy of this burden estimate, and suggestions for reducing the burden should be directed to the Department of the Treasury, Financial Crimes Enforcement Network, Suite 200, 2070 Chain Bridge Road, Vienna, VA 22182-2536. You are not required to provide the requested information unless a form displays a valid OMB control number.

Exhibit 19.4 (continued)

**INSTRUCTIONS****General Instructions**

**Who Must File this Report** Each United States person, who has a financial interest in or signature authority, or other authority over any financial accounts, including bank, securities, or other types of financial accounts in a foreign country, if the aggregate value of these financial accounts exceeds \$10,000 at any time during the calendar year, must report that relationship each calendar year by filing TD F 90-22.1 with the Department of the Treasury on or before June 30, of the succeeding year.

**Exceptions**

An officer or employee of a bank which is subject to the supervision of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Office of Thrift Supervision, or the Federal Deposit Insurance Corporation need not report that he has signature or other authority over a foreign bank, securities or other financial account maintained by the bank, if the officer or employee has NO personal financial interest in the account.

An officer or employee of a domestic corporation whose equity securities are listed upon national securities exchanges or which has assets exceeding \$10 million and 500 or more shareholders of record need not file such a report concerning the other signature authority over a foreign financial account of the corporation, if he has NO personal financial interest in the account and he has been advised in writing by the chief financial officer of the corporation that the corporation has filed a current report, which includes that account.

Report any financial account (except a military banking facility as defined in these instructions) that is located in a foreign country, even if it is held at an affiliate of a United States bank or other financial institution. Do not report any account maintained with a branch, agency, or other office of a foreign bank or other institution that is located in the United States, Guam, Puerto Rico, and the Virgin Islands.

**General Definitions**

**United States Person** The term "United States person" means (1) a citizen or resident of the United States, (2) a domestic partnership, (3) a domestic corporation, or (4) a domestic estate or trust.

**Financial Account** Generally includes any bank, securities, securities derivatives or other financial instruments accounts. Such accounts generally also encompass any accounts in which the assets are held in a commingled fund, and the account owner holds an equity interest in the fund. The term also means any savings, demand, checking, deposit, time deposit, or any other account maintained with a financial institution or other person engaged in the business of a financial institution.

**Account in a Foreign Country** A "foreign country" includes all geographical areas located outside the United States, Guam, Puerto Rico, and the Virgin Islands.

**Financial Interest** A financial interest in a bank, securities, or other financial account in a foreign country means an interest described in either of the following two paragraphs:

(1) A United States person has a financial interest in each account for which such person is the owner of record or has legal title, whether the account is maintained for his or her own benefit or for the benefit of others including non-United States persons. If an account is maintained in the name of two persons jointly, or if several persons each own a partial interest in an account, each of those United States persons has a financial interest in that account.

(2) A United States person has a financial interest in each bank, securities, or other financial account in a foreign country for which the owner of record or holder of legal title is: (a) a person acting as an agent, nominee, attorney, or in some other capacity on behalf of the U.S. person; (b) a corporation in which the United States person owns directly or indirectly more than 50 percent of the total value of shares of stock; (c) a partnership in which the United States person owns an interest in more than 50 percent of the profits (distributive share of income); or (d) a trust in which the United States person either has a present beneficial interest in more than 50 percent of the assets or from which such person receives more than 50 percent of the current income.

**Signature or Other Authority Over an Account** A person has signature authority over an account if such person can control the disposition of money or other property in it by delivery of a document containing his or her signature (or his or her signature and that of one or more other persons) to the bank or other person with whom the account is maintained.

Other authority exists in a person who can exercise comparable power over an account by direct communication to the bank or other person with whom the account is maintained, either orally or by some other means.

**Military Banking Facility** Do not consider as an account in a foreign country, an account in an institution known as a "United States military banking facility" (or "United States military finance facility") operated by a United States financial institution designated by the United States Government to serve U.S. Government installations abroad, even if the United States military banking facility is located in a foreign country.

**Filing Information**

**When and Where to File** - This report must be filed on or before June 30 each calendar year with the Department of the Treasury, Post Office Box 32621, Detroit, MI 48232-0621, or it may be hand carried to any local office of the Internal Revenue Service for forwarding to the Department of the Treasury, Detroit, MI.

**EXPLANATIONS FOR SPECIFIC ITEMS****Consolidated Reporting**

A corporation which owns directly or indirectly more than 50 percent interest in one or more other entities will be permitted to file a consolidated report on TD F 90-22.1, on behalf of itself and such other entities provided that a listing of them is made part of the consolidated report. Such reports should be signed by an authorized official of the parent corporation.

If the group of entities covered by a consolidated report has a financial interest in 25 or more foreign financial accounts, the reporting corporation need only note that fact on the form in Item 20. It will, however, be required to provide detailed information concerning each account when so requested by the Secretary or his delegate.

**Item 14**

If the filer owns the account jointly with any other party, then yes should be marked.

**Item 15**

If the filer holds this account with only one (1) other party, and all accounts listed are held jointly with that party, then complete items 16, 17, 18, and 19. Otherwise leave these items blank.

**Item 20**

If the filer holds a financial interest in more than 25 foreign financial accounts, indicate the number in this box and do not complete any further items in Part II.

Any person who lists more than 25 foreign financial accounts in item 20 must when requested by the Department of the Treasury provide all the information called for in Part II.

**Item 22****Account Valuation**

For item 22, the maximum value of an account is the largest amount of currency and non-monetary assets that appear on any quarterly or more frequent account statement issued for the applicable year. If periodic account statements are not so issued, the maximum account asset value is the largest amount of currency and non-monetary assets in the account at any time during the year. Convert foreign currency by using the official exchange rate at the end of the year. In valuing currency of a country that uses multiple exchange rates, use the rate which would apply if the currency in the account were converted into United States dollars at the close of the calendar year.

The value of stock, other securities or other non-monetary assets in an account reported on TD F 90-22.1 is the fair market value at the end of the calendar year, or if withdrawn from the account, at the time of the withdrawal.

For purposes of item 22, if you had a financial interest in more than one account, each account is to be valued separately in accordance with the foregoing two paragraphs. If you had a financial interest in one or more but fewer than 25 accounts, and you are unable to determine whether the maximum value of these accounts exceeded \$10,000 at any time during the year, complete Part II or III for each of these accounts.

**Item 26**

**United States Persons with Authority Over but No Financial Interest in an Account** - Except as provided in the following paragraph, you must state the name, address, and identifying number of each owner of an account over which you had authority, but if you complete items 27-35 for more than one account of the same owner, you need identify the owner only once. If you complete items 27-35 for one or more accounts in which no United States person had a financial interest, you may state on the first line of this item, in lieu of supplying information about the owner, "No U.S. person had any financial interest in the foreign account." This statement must be based upon the actual belief of the person filing this form after he or she has taken reasonable measures to ensure its correctness.

If you complete Part II for accounts owned by a domestic corporation and its domestic and/or foreign subsidiaries, you may treat them as one owner and write in the space provided, the name of the parent corporation, followed by "and related entities," and the identifying number and address of the parent corporation.

**Item 36****Signature**

This report must be signed by the person named in Part I. If the report is being filed on behalf of a partnership, corporation, or fiduciary, it must be signed by an authorized individual.

**Penalties**

For criminal penalties for failure to file a report, supply information, and for filing a false or fraudulent report, see 31 USC 5322(a), 31 USC 5322(b), and 18 USC 1001.

**Exhibit 19.4 (continued)**

Form **8362**  
(Rev. July 1997)

Department of the Treasury  
Internal Revenue Service

**Currency Transaction Report by Casinos**  
▶ Use this revision for reportable transactions occurring after June 30, 1997.  
▶ Please type or print.  
(Complete all applicable parts—see instructions.)

OMB No. 1506-0005

1 If this Form 8362 (CTRC) is submitted to amend a prior report check here:  and attach a copy of the original CTCR to this form.

**Part I Person(s) Involved in Transaction(s)**

**Section A—Person(s) on Whose Behalf Transaction(s) Is Conducted (Customer)**

2  Multiple persons

3 Individual's last name or Organization's name 4 First name 5 M.I.

6 Permanent address (number, street, and apt. or suite no.) 7 SSN or EIN

8 City 9 State 10 ZIP code 11 Country (if not U.S.) 12 Date of birth M M D D Y Y Y Y

13 Method used to verify identity: a  Examined identification credential/document b  Known customer - information on file c  Organization

14 Describe identification credential: a  Driver's license/State I.D. b  Passport c  Alien registration d  Other  
e Issued by: f Number:

15 Customer's Account Number

**Section B—Individual(s) Conducting Transaction(s) - If other than above (Agent)**

16  Multiple agents

17 Individual's last name 18 First name 19 M.I.

20 Permanent address (number, street, and apt. or suite no.) 21 SSN

22 City 23 State 24 ZIP code 25 Country (if not U.S.) 26 Date of birth M M D D Y Y Y Y

27 Method used to verify identity: a  Examined identification credential/document b  Known customer - information on file

28 Describe identification credential: a  Driver's license/State I.D. b  Passport c  Alien registration d  Other  
e Issued by: f Number:

**Part II Amount and Type of Transaction(s) (Complete all items that apply.)**

29  Multiple transactions

30 CASH IN: (in U.S. dollar equivalent)  
a Purchase(s) of casino chips, tokens, and other gaming instruments \$ \_\_\_\_\_  
b Deposit(s) (front money or safekeeping) \_\_\_\_\_  
c Payment(s) on credit (including markers) \_\_\_\_\_  
d Bet(s) of currency \_\_\_\_\_  
e Currency received from wire transfer(s) out \_\_\_\_\_  
f Purchase(s) of casino check(s) \_\_\_\_\_  
g Currency exchange(s) \_\_\_\_\_  
h Other (specify) \_\_\_\_\_  
i Enter total amount of CASH IN transaction(s) ▶ \$ \_\_\_\_\_

31 CASH OUT: (in U.S. dollar equivalent)  
a Redemption(s) of casino chips, tokens, and other gaming instruments \$ \_\_\_\_\_  
b Withdrawal(s) of deposit (front money or safekeeping) \_\_\_\_\_  
c Advance(s) on credit (including markers) \_\_\_\_\_  
d Payment(s) on bet(s) (including slot jackpot(s)) \_\_\_\_\_  
e Currency paid from wire transfer(s) in \_\_\_\_\_  
f Negotiable instrument(s) cashed (including checks) \_\_\_\_\_  
g Currency exchange(s) \_\_\_\_\_  
h Travel and complimentary expenses and gaming incentives \_\_\_\_\_  
i Payment for tournament, contest or other promotions \_\_\_\_\_  
j Other (specify) \_\_\_\_\_  
k Enter total amount of CASH OUT transaction(s) ▶ \$ \_\_\_\_\_

32 Date of transaction M M D D Y Y Y Y (see instructions) 33 Foreign currency used (Country)

**Part III Casino Reporting Transaction(s)**

34 Casino's trade name 35 Casino's legal name 36 Employer identification number (EIN)

37 Address (number, street, and apt. or suite no.) where transaction occurred

38 City 39 State 40 ZIP code

41 Title of approving official 42 Signature of approving official 43 Date of signature M M D D Y Y Y Y

44 Type or print preparer's name 45 Type or print name of person to contact 46 Contact telephone number

Sign Here ▶

For Paperwork Reduction Act Notice, see page 2.

Cat. No. 62291Z

Form **8362** (Rev. 7-97)

Exhibit 19.5 Form 8362, Currency Transaction Report by Casinos.



**Multiple Persons or Multiple Agents**

(Complete applicable parts below if box 2 or box 16 on page 1 is checked.)

**Part I Continued**

**Section A—Person(s) on Whose Behalf Transaction(s) Is Conducted (Customer)**

3 Individual's last name or Organization's name			4 First name			5 M.I.		
6 Permanent address (number, street, and apt. or suite no.)						7 SSN or EIN		
8 City	9 State	10 ZIP code	11 Country (if not U.S.)			12 Date of birth		
13 Method used to verify identity: a <input type="checkbox"/> Examined identification credential/document b <input type="checkbox"/> Known customer - information on file c <input type="checkbox"/> Organization								
14 Describe identification credential: a <input type="checkbox"/> Driver's license/State I.D. b <input type="checkbox"/> Passport c <input type="checkbox"/> Alien registration d <input type="checkbox"/> Other								
15 Customer's Account Number								

**Section B—Individual(s) Conducting Transaction(s) – If other than above (Agent)**

17 Individual's last name			18 First name			19 M.I.		
20 Permanent address (number, street, and apt. or suite no.)						21 SSN		
22 City	23 State	24 ZIP code	25 Country (if not U.S.)			26 Date of birth		
27 Method used to verify identity: a <input type="checkbox"/> Examined identification credential/document b <input type="checkbox"/> Known customer - information on file								
28 Describe identification credential: a <input type="checkbox"/> Driver's license/State I.D. b <input type="checkbox"/> Passport c <input type="checkbox"/> Alien registration d <input type="checkbox"/> Other								

**Paperwork Reduction Act Notice.**—The requested information is useful in criminal, tax, and regulatory investigations and proceedings. Financial institutions are required to provide the information under 31 U.S.C. 5313 and 31 CFR Part 103, commonly referred to as the Bank Secrecy Act (BSA). The BSA is administered by the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN). You are not required to provide the requested information unless a form displays a valid OMB control number.

The time needed to complete this form will vary depending on individual circumstances. The estimated average time is 19 minutes. If you have comments concerning the accuracy of this time estimate or suggestions for improving this form, you may write to the **Tax Forms Committee**, Western Area Distribution Center, Rancho Cordova, CA 95743-0001. **DO NOT** send this form to this address. Instead, see **When and Where To File** below.

**General Instructions**

**Form 8362.**—Use the July 1997 revision of Form 8362 for reportable transactions occurring after June 30, 1997. Use the May 1992 revision of Form 8362 for reportable transactions occurring before July 1, 1997.

**Suspicious Transactions.**—If a transaction is greater than \$10,000 in currency as well as suspicious, casinos must file a Form 8362 and are encouraged to report suspicious transactions and activities on **Form TDF 90-22.47**, Suspicious Activity Report (SAR). Banks and other depository institutions currently are required to use the SAR to report suspicious activities. A SAR for casinos is under development and, once issued, a casino will use this SAR for reporting a suspicious transaction or activity, rather than reporting such activity on Form TDF 90-22.47.

**DO NOT** use Form 8362 to (1) report suspicious transactions involving \$10,000 or less in currency OR (2) indicate that a transaction of more than \$10,000 is suspicious.

When a suspicious activity requires immediate attention, casinos should telephone 1-800-800-CTRS, Monday through Friday, from 9:00 a.m. to 6:00 p.m. Eastern Standard Time (EST). An Internal Revenue Service (IRS) employee will direct the call to the local office of the IRS Criminal Investigation Division (CID). In an emergency, consult directory assistance for the local IRS CID office.

**Who Must File.**—Any organization duly licensed or authorized to do business as a casino or gambling casino in the United States (except casinos located in Nevada) and having gross annual gaming revenues in excess of \$1 million must file Form 8362. This includes the principal headquarters and every domestic branch or place of business of the casino.

**Note:** Nevada casinos must file Form 8852, *Currency Transaction Report by Casinos - Nevada (CTRC-N)*, to report transactions as required under Nevada Regulation 6A.

**What To File.**—A casino must file Form 8362 for each transaction involving either currency received (Cash In) or currency disbursed (Cash Out) of more than \$10,000 in a gaming day. A gaming day is the normal business day of the casino by which it keeps its books and records for business, accounting, and tax purposes. Multiple transactions must be treated as a single transaction if the casino has knowledge that: (1) they are made by or on behalf of the same person, and (2) they result in either Cash In or Cash Out by the casino totalling more than \$10,000 during any one gaming day. Reportable transactions may occur at a casino cage, gaming table, and/or

slot machine. The casino should report both Cash In and Cash Out transactions by or on behalf of the same customer on a single Form 8362. **DO NOT** use Form 8362 to report receipts of currency in excess of \$10,000 by nongaming businesses of a casino (e.g., a hotel); instead, use **Form 8300**, Report of Cash Payments Over \$10,000 Received in a Trade or Business.

**Exceptions.**—A casino does not have to report transactions with domestic banks, currency dealers or exchangers, or commercial check cashers.

**Identification Requirements.**—All individuals (except employees conducting transactions on behalf of armored car services) conducting a reportable transaction(s) for themselves or for another person must be identified by means of an official or otherwise reliable record.

Acceptable forms of identification include a driver's license, military or military dependent identification cards, passport, alien registration card, state issued identification card, cedular card (foreign), or a combination of other documents that contain an individual's name and address and preferably a photograph and are normally acceptable by financial institutions as a means of identification when cashing checks for persons other than established customers.

For casino customers granted accounts for credit, deposit, or check cashing, or on whom a CTRC containing verified identity has been filed, acceptable identification information obtained previously and maintained in the casino's internal records may be used as long as the following conditions are met. The customer's identity is reverified periodically, any out-of-date identifying information is updated in the internal records, and the date of each reverification is noted on the internal

record. For example, if documents verifying an individual's identity were examined and recorded on a signature card when a deposit or credit account was opened, the casino may rely on that information as long as it is reverified periodically.

**When and Where To File.**—File each Form 8362 by the 15th calendar day after the date of the transaction with the:

IRS Detroit Computing Center  
ATTN: CTRC  
P.O. Box 32621  
Detroit, MI 48232-5604

A casino must retain a copy of each Form 8362 filed for 5 years from the date of filing.

**Penalties.**—Civil and/or criminal penalties may be assessed for failure to file a CTRC or supply information, or for filing a false or fraudulent CTRC. See 31 U.S.C. 5321, 5322, and 5324.

**Definitions.**—For purposes of Form 8362, the terms below have the following meanings:

**Agent.** Any individual who conducts a currency transaction on behalf of another individual or organization.

**Currency.** The coin and paper money of the United States or of any other country that is circulated and customarily used and accepted as money.

**Customer.** Any person involved in a currency transaction whether or not that person participates in the casino's gaming activities.

**Person.** An individual, corporation, partnership, trust or estate, joint stock company, association, syndicate, joint venture, or any other unincorporated organization or group.

**Organization.** Person other than an individual.

**Transaction In Currency (Currency Transaction).** The physical transfer of currency from one person to another.

**Negotiable Instruments.** All checks and drafts (including business, personal, bank, cashier's, and third-party), traveler's checks, money orders, and promissory notes, whether or not they are in bearer form.

**Specific Instructions**

**Note:** Additional information that cannot fit on the front and back of Form 8362 must be submitted on plain paper attached to Form 8362. Type or print the individual's or organization's name and identifying number, date of transaction, and casino's name and employer identification number (i.e., Items 3, 4, 5, 7, 32, 34, 35, and 36) as well as identify the specific item number on all additional sheets. This will ensure that if a sheet becomes separated, it will be associated with the appropriate Form 8362.

**Item 1. Amends prior report.**—Check Item 1 if this Form 8362 amends a previously filed report. Staple a copy of the original report behind the amended one. Complete Part III in its entirety, but complete only those other entries that are being amended.

**Part I. Person(s) Involved in Transaction(s)**

**Note:** Section A must be completed in all cases. If an individual conducts a transaction on his/her own behalf, complete only Section A; leave Section B BLANK. If a transaction is

conducted by an individual on behalf of another person(s), complete Section A for each person on whose behalf the transaction is conducted; complete Section B for the individual conducting the transaction.

**Section A. Person(s) on Whose Behalf Transaction(s) Is Conducted (Customer)**

**Item 2. Multiple persons.**—Check Item 2 if this transaction is being conducted on behalf of more than one person. For example, if John and Jane Doe cash a check made out to them jointly at the casino, more than one individual has conducted the transaction. Enter information in Section A for one of the individuals; provide information for the other individual on page 2, Section A. Attach additional sheets as necessary.

**Items 3, 4, and 5. Individual/Organization name.**—If the person on whose behalf the transaction(s) is conducted is an individual, put his/her last name in Item 3, first name in Item 4 and middle initial in Item 5. If there is no middle initial, leave Item 5 BLANK. If the transaction is conducted on behalf of an organization, enter the name in Item 3 and leave Items 4 and 5 BLANK, but identify the individual conducting the transaction in Section B. If an organization has a separate "doing business as (DBA)" name, enter in Item 3 the organization's legal name (e.g., Smith Enterprises, Inc.) followed by the name of the business (e.g., DBA Smith Casino Tours). In this case, use Items 4 and 5 if more space is needed.

**Items 6, 8, 9, 10, and 11. Address.**—Enter the permanent street address, city, two-letter state abbreviation used by the U.S. Postal Service, and ZIP code of the person identified in Item 3. Also, enter in Item 6 the apartment or suite number and road or route number. Do not enter a P.O. box number unless the person has no street address. If the person is from a foreign country, enter any province name as well as the appropriate two-letter country code (e.g., "CA" for Canada, "JA" for Japan, etc.). If the country is the United States, leave Item 11 BLANK.

**Item 7. Social security number (SSN) or Employer identification number (EIN).**—Enter the SSN (if an individual) or EIN (if other than an individual) of the person identified in Items 3 through 5. If that individual is a nonresident alien individual who does not have an SSN, enter "NONE" in this space.

**Item 12. Date of birth.**—Enter the customer's date of birth (DOB) if it is known to the casino through an existing internal record or reflected on an appropriate identification document or credential presented to the casino to verify the customer's identity (see Identification Requirements above). Internal casino records can include those for casino customers granted accounts for credit, deposit, or check cashing, or on whom a CTRC containing verified identity has been filed. If such records do not indicate the DOB, a casino should ask the customer for the DOB. If the DOB is not available from any of these sources, the casino should enter NOT AVAILABLE in the space. Eight numerals must be inserted for each date. Enter the date in the format "mmddyyyy", where "mm" is the month, "dd" is the day, and "yyyy" is the year. Zero (0) should precede any single-digit number. For example, if the

individual's birth date is June 1, 1948, enter "06 01 1948" in Item 12.

**Item 13. Method used to verify identity.**—If an individual conducts the transaction(s) on his/her own behalf, his/her name and address must be verified by examination of an official credential/document or internal record containing identification information on a known customer (see Identification Requirements above). Check box a if you examined an official identification credential/document. Check box b if you examined an acceptable internal casino record (i.e., credit, deposit, or check cashing account record, or a CTRC worksheet) containing previously verified identification information on a "known customer." Check box c if the transaction is conducted on behalf of an organization. If box a or b is checked, you must complete Item 14. If box c is checked, do not complete Item 14.

**Item 14. Describe identification credential.**—If a driver's license, passport, or alien registration card was used to verify the individual's identity, check as appropriate box a, b, or c. If you check box d, you must specifically identify the type of document used (e.g., enter "military ID" for a military or military/dependent identification card). A statement such as "known customer" in box d is not sufficient for completion of Form 8362. Enter in Item 14e the two-letter state postal code, two-letter country code, or the name of the issuer for that document, and enter in Item 14f the number shown on that official document.

**Item 15. Customer account number.**—Enter the account number which corresponds to the transaction being reported and which the casino has assigned to the person whose name is entered in Item 3. If the person has more than one account number affected by the transaction, enter the account number that corresponds to the majority of currency being reported. If the transaction does not involve an account number, enter "NOT APPLICABLE" in the space.

**Section B. Individual(s) Conducting Transaction(s) – If Other Than Above (Agent)**

Complete Section B if an individual conducts a transaction on behalf of another person(s) listed in Section A. If an individual conducts a transaction on his/her own behalf, leave Section B BLANK.

**Item 16. Multiple agents.**—If, during a gaming day, more than one individual conducts transactions on behalf of an individual or organization listed in Section A, check this box and complete Section B. List one of the individuals on the front of the form and the other individual(s) on page 2, Section B. Attach additional sheets as necessary.

**Items 17, 18, and 19. Name of individual.**—Enter the individual's last name in Item 17, first name in Item 18, and middle initial in Item 19. If there is no middle initial, leave Item 19 BLANK. For example, if John Doe, an employee of the Error Free Rock Band, cashes an \$11,000 check for the band, Error Free Rock Band is identified in Section A, and John Doe is identified in Section B.

**Items 20, 22, 23, 24, and 25. Address.**—Enter the permanent street address, including ZIP code, of the individual conducting the

transaction. If the individual is from a foreign country, enter any province name and the appropriate two-letter country code.

**Item 21. Social security number (SSN).**—Enter the SSN of the individual identified in Items 17 through 19. If that individual is a nonresident alien who does not have an SSN, enter "NONE" in the space.

**Item 26. Date of birth.**—Enter the individual's date of birth. For proper format, see the instructions under **Item 12** above.

**Item 27. Method used to verify identity.**—Any individual listed in Items 17 through 19 must present an official document to verify his/her name and address. See the instructions under **Item 13** above for more information. After completing Item 27, you must also complete Item 28.

**Item 28. Describe identification credential.**—Describe the identification credential used to verify the individual's name and address. See the instructions under **Item 14** above for more information.

## Part II. Amount and Type of Transaction(s)

Part II identifies the type of transaction(s) reported and the amount(s) involved. You must complete all items that apply.

**Item 29. Multiple transactions.**—Check this box if multiple currency transactions, none of which individually exceeds \$10,000, comprise this report.

**Items 30 and 31. Cash in and cash out.**—Enter in the appropriate spaces provided in Items 30 and/or 31, the specific currency amount for each "type of transaction" for a reportable Cash In or Cash Out. If the casino engages in a Cash In or a Cash Out transaction that is not listed in Items 30a through 30g or Items 31a through 31i, specify the type of transaction and the amount of currency in Item 30h or 31j, respectively. Enter the total amount of the reportable Cash In transaction(s) in Item 30i. Enter the total amount of the reportable Cash Out transaction(s) in Item 31k.

If less than a full dollar amount is involved, increase the figure to the next higher dollar. For example, if the currency total is \$20,500.25, show it as \$20,501.00.

If there is a currency exchange, list it separately with both the Cash In and Cash Out totals. If foreign currency is exchanged, use the U.S. dollar equivalent on the day of the transaction.

Payment(s) on credit, Item 30c, includes all forms of cash payments made by a customer on a credit account or line of credit, or in redemption of markers or counter checks. Currency received from wire transfer(s) out, Item 30e, applies to cash received from a customer when the casino sends a wire transfer on behalf of a customer.

Currency paid from wire transfer(s) in, Item 31e, applies to cash paid to a customer when the casino receives a wire transfer on behalf of a customer. Travel and complimentary expenses and gaming incentives, Item 31h, includes reimbursements for a customer's travel and entertainment expenses and cash complementaries ("comps").

## Determining Whether Transactions Meet The Reporting Threshold

Only cash transactions that, alone or when aggregated, exceed \$10,000 should be reported on Form 8362. A casino must report multiple currency transactions when it has knowledge that such transactions have occurred. This includes knowledge gathered through examination of books, records, logs, information retained on magnetic disk, tape or other machine-readable media, or in any manual system, and similar documents and information that the casino maintains pursuant to any law or regulation or within the ordinary course of its business.

Cash In and Cash Out transactions for the same customer are to be aggregated separately and must not be offset against one another. If there are both Cash In and Cash Out transactions which each exceed \$10,000, enter the amounts in Items 30 and 31 and report on a single Form 8362.

**Example 1.** Person A purchases \$11,000 in chips with currency (one Cash In entry); and later receives currency from a \$6,000 redemption of chips and a \$2,000 slot jackpot win (two Cash Out entries). Complete Form 8362 as follows:

Cash In of "\$11,000" is entered in Item 30a (purchase of chips) and Cash In Total of "\$11,000" is entered in Item 30i. No entry is made for Cash Out. The two Cash Out transactions equal only \$8,000, which does not meet the BSA reporting threshold.

**Example 2.** Person B deposits \$5,000 in currency to his front money account and pays \$10,000 in currency to pay off an outstanding credit balance (two Cash In entries); receives \$7,000 in currency from a wire transfer (one Cash Out entry); and presents \$2,000 in small denomination U.S. currency to be exchanged for an equal amount in U.S. \$100 bills. Complete Form 8362 as follows:

Cash In of "\$5,000" is entered in Item 30b (deposit), "\$10,000" is entered in Item 30c (payment on credit), "\$2,000" is entered in Item 30g (currency exchange), and Cash In Total of "\$17,000" is entered in Item 30i. In determining whether the transactions are reportable, the currency exchange is aggregated with both the Cash In and the Cash Out amounts. The result is a reportable \$17,000 Cash In transaction. No entry is made for Cash Out. The total Cash Out amount only equals \$9,000, which does not meet the BSA reporting threshold.

**Example 3.** Person C deposits \$7,000 in currency to his front money account and pays \$9,000 in currency to pay off an outstanding credit balance (two Cash In entries); receives \$2,500 in currency from a withdrawal from a safekeeping account, \$2,500 in currency from a wire transfer and cashes a personal check of \$7,500 (three Cash Out entries); and presents Canadian dollars which are exchanged for \$1,500 in U.S. dollar equivalent. Complete Form 8362 as follows:

Cash In of "\$7,000" is entered in Item 30b (deposit), "\$9,000" is entered in Item 30c (payment on credit), "\$1,500" is entered in Item 30g (currency exchange), and Cash In total of "\$17,500" is entered in Item 30i. Cash Out of "\$2,500" is entered in Item 31b (withdrawal of deposit), "\$2,500" is entered in Item 31e (wire transfer), "\$7,500" is entered in

Item 31f (negotiable instrument cashed), "\$1,500" is entered in Item 31g (currency exchange) and a Cash Out Total of "\$14,000" is entered in Item 31k. In this example, both the Cash In and Cash Out totals exceed \$10,000, and each must be reflected on Form 8362.

**Example 4.** Person D purchases \$10,000 in chips with currency and places a \$10,000 cash bet (two Cash In entries); and later receives currency for an \$18,000 redemption of chips and \$20,000 from a payment on a cash bet (two Cash Out entries). Complete Form 8362 as follows:

Cash In of "\$10,000" is entered in Items 30a and 30d and a Cash In total of "\$20,000" is entered in Item 30i. Cash Out of "\$18,000" is entered in Item 31a (redemption of chips), "\$20,000" is entered in Item 31d (payment on bets) and a Cash Out Total of "\$38,000" is entered in Item 31k. In this example, both the Cash In and Cash Out totals exceed \$10,000, and each must be reflected on Form 8362.

**Item 32. Date of transaction.**—Enter the gaming day on which the transaction occurred (see **What To File** above). For proper format, see the instructions for **Item 12** above.

**Item 33. Foreign currency.**—If foreign currency is involved, identify the country of issuance by entering the appropriate two-letter country code. If multiple foreign currencies are involved, identify the country for which the largest amount in U.S. dollars is exchanged.

## Part III. Casino Reporting Transaction(s)

**Item 34. Casino's trade name.**—Enter the name by which the casino does business and is commonly known. Do not enter a corporate, partnership, or other entity name, unless such name is the one by which the casino is commonly known.

**Item 35. Casino's legal name.**—Enter the legal name as shown on required tax filings, only if different from the trade name shown in Item 34. This name will be defined as the name indicated on a charter or other document creating the entity, and which is identified with the casino's established EIN.

**Item 36. Employer identification number (EIN).**—Enter the casino's EIN.

**Items 37, 38, 39, and 40. Address.**—Enter the street address, city, state, and ZIP code of the casino (or branch) where the transaction occurred. Do not use a P.O. box number.

**Items 41 and 42. Title and signature of approving official.**—The official who is authorized to review and approve Form 8362 must indicate his/her title and sign the form.

**Item 43. Date the form is signed.**—The approving official must enter the date the Form 8362 is signed. For proper format, see the instructions for **Item 12** above.

**Item 44. Preparer's name.**—Type or print the full name of the individual preparing Form 8362. The preparer and the approving official may be different individuals.

**Items 45 and 46. Contact person/telephone number.**—Type or print the name and commercial telephone number of a responsible individual to contact concerning any questions about this Form 8362.



Department of the Treasury <b>TD F 90-22.55</b> Issued November 2001 OMB No. 1506-0013		<h2 style="margin: 0;">Registration of Money Services Business</h2>			Do not write in this space.
1 Date of Filing M M D D Y Y Y Y		2 Type of Filing a <input type="checkbox"/> Initial Registration b <input type="checkbox"/> 2 Year Update c <input type="checkbox"/> Corrects Prior Filing		d <input type="checkbox"/> Refiling because: Check all that apply [see instructions]. 1 <input type="checkbox"/> re-registered under state law 2 <input type="checkbox"/> more than 10 percent transfer of equity interest 3 <input type="checkbox"/> more than 50 percent increase in agents	
<b>Part I Registrant Information</b>					
3 Organization Name			4 Doing Business As (DBA)		
5 Address (Number, Street, and Apt. or Suite No.)				6 Taxpayer Identification Number	
7 City		8 State	9 Zip Code	10 Telephone Number (include area code)	
<b>Part II Owner or Controlling Person Information</b>					
11 Individual's last name or Organization's name			12 First Name		13 Middle Initial
14 Address (Number, Street, and Apt. or Suite No.)				15 Telephone Number - (include area code)	
16 City		17 State	18 Zip Code		
19 Country (if other than US)			20 Date of Birth M M D D Y Y Y Y		21 Taxpayer Identification Number
22 If an individual, provide identification information for Owner or Controlling Person (Provide at least one)					
a <input type="checkbox"/> Driver's Lic./State ID		b <input type="checkbox"/> Passport		c <input type="checkbox"/> Alien Registration	
d <input type="checkbox"/> Other					
e Number					
f Issuer of Identification					
<b>Part III Money Services Information</b>					
23 Where services are offered: Check as many as apply. a <input type="checkbox"/> All States and Territories b <input type="checkbox"/> All States				24 Number of Branches of Registrant	
<input type="checkbox"/> Alabama (AL) <input type="checkbox"/> Idaho (ID) <input type="checkbox"/> Montana (MT) <input type="checkbox"/> Puerto Rico (PR) <input type="checkbox"/> Alaska (AK) <input type="checkbox"/> Illinois (IL) <input type="checkbox"/> Nebraska (NE) <input type="checkbox"/> Rhode Island (RI) <input type="checkbox"/> American Samoa (AS) <input type="checkbox"/> Indiana (IN) <input type="checkbox"/> Nevada (NV) <input type="checkbox"/> South Carolina (SC) <input type="checkbox"/> Arizona (AZ) <input type="checkbox"/> Iowa (IA) <input type="checkbox"/> New Hampshire (NH) <input type="checkbox"/> South Dakota (SD) <input type="checkbox"/> Arkansas (AR) <input type="checkbox"/> Kansas (KS) <input type="checkbox"/> New Jersey (NJ) <input type="checkbox"/> Tennessee (TN) <input type="checkbox"/> California (CA) <input type="checkbox"/> Kentucky (KY) <input type="checkbox"/> New Mexico (NM) <input type="checkbox"/> Texas (TX) <input type="checkbox"/> Colorado (CO) <input type="checkbox"/> Louisiana (LA) <input type="checkbox"/> New York (NY) <input type="checkbox"/> Utah (UT) <input type="checkbox"/> Connecticut (CT) <input type="checkbox"/> Maine (ME) <input type="checkbox"/> North Carolina (NC) <input type="checkbox"/> Vermont (VT) <input type="checkbox"/> Delaware (DE) <input type="checkbox"/> Maryland (MD) <input type="checkbox"/> North Dakota (ND) <input type="checkbox"/> Virgin Islands (VI) <input type="checkbox"/> District of Columbia (DC) <input type="checkbox"/> Massachusetts (MA) <input type="checkbox"/> Northern Mariana Islands (MP) <input type="checkbox"/> Virginia (VA) <input type="checkbox"/> Florida (FL) <input type="checkbox"/> Michigan (MI) <input type="checkbox"/> Ohio (OH) <input type="checkbox"/> Washington (WA) <input type="checkbox"/> Georgia (GA) <input type="checkbox"/> Minnesota (MN) <input type="checkbox"/> Oklahoma (OK) <input type="checkbox"/> West Virginia (WV) <input type="checkbox"/> Guam (GU) <input type="checkbox"/> Mississippi (MS) <input type="checkbox"/> Oregon (OR) <input type="checkbox"/> Wisconsin (WI) <input type="checkbox"/> Hawaii (HI) <input type="checkbox"/> Missouri (MO) <input type="checkbox"/> Pennsylvania (PA) <input type="checkbox"/> Wyoming (WY)				25 Services Offered by Registrant at its Branches: Check as many as apply. a <input type="checkbox"/> Traveler's Checks issue b <input type="checkbox"/> Traveler's Checks sales and/or redemption c <input type="checkbox"/> Money Orders issue d <input type="checkbox"/> Money Orders sales and/or redemption e <input type="checkbox"/> Currency Exchange f <input type="checkbox"/> Check Cashing g <input type="checkbox"/> Money Transmission	
				26 Is this a mobile operation? a <input type="checkbox"/> Yes    b <input type="checkbox"/> No	
<b>Paperwork Reduction Act.</b> The estimated average burden associated with this collection of information is 45 minutes per respondent or recordkeeper, depending on individual circumstances. Comments regarding the accuracy of this burden estimate, and suggestions for reducing the burden should be directed to the Paperwork Reduction Act, Department of the Treasury, Financial Crimes Enforcement Network, P.O. Box 1618, Vienna, VA 22183-1618. You are not required to provide the requested information unless a form displays a valid OMB control number.					

Exhibit 19.6 Form TD F 90-22.55, Registration of Money Services Business.



**General Instructions for TD F 90-22.55**

All fields must be completed in their entirety.

**When to File**

**Initial Registration:** Item 2a. File the form by December 31, 2001 or within 180 days after the business begins operations, whichever is later.

**2-Year Update:** Item 2b. File the form not later than December 31 of the second calendar year in each two year registration period. See 31 CFR 103.41(b)(2).

**Corrects Prior Filing:** Item 2c. File this form to correct a prior report. Complete Part I in its entirety and only those other entries that are being amended. Staple a copy of the prior report (or the acknowledgement from DCC if received) to the corrected report.

**Refiling:** Item 2d. Refile the form if:

- 1 there has been a change in ownership requiring re-registration under state registration law;
  - 2 more than 10 percent of voting power or equity interest has been transferred (except certain publicly-traded companies) or;
  - 3 the number of agents has increased by more than 50 percent.
- See 31 CFR 103.41(b)(4).

**Who should file:**

Each money services business, except one that is a money services business solely because it serves as an agent of another money services business, must register. Money services businesses include:

- money transmitters;
  - currency exchangers (except those who do not exchange more than \$1,000 for any one customer on any day);
  - check cashers (except those who do not cash checks totaling more than \$1,000 for any one customer on any day);
  - issuers of traveler's checks or money orders (except those who do not issue more than \$1,000 in traveler's checks or money orders for any one customer on any day);
  - sellers or redeemers of traveler's checks or money orders (except those who do not sell or redeem more than \$1,000 in traveler's checks or money orders for any one customer on any day).
- See 31 CFR 103.11(n) and (uu).

Excluded from the registration requirement are the United States Postal Service, any agency of the United States, of any state or of any political subdivision of any state. At this time, persons are not required to register to the extent that they issue, sell or redeem stored value. If, however, a money services business provides money services in addition to stored value, the provision of stored value services does not relieve it of the responsibility to register, if required, as a provider of those other services.

**Where to file:** Send this completed form to:  
**IRS Detroit Computing Center**  
**Attn: Money Services Business Registration**  
**P.O. Box 33116**  
**Detroit, MI 48232-0116**

Keep a copy of this registration form.

**Penalties for failure to comply:** Any person who fails to comply with the requirements to register, keep records, and/or maintain agent lists pursuant to 31 CFR 103.41 shall be liable for a civil penalty of \$5,000 for each violation. Failure to comply may also subject a person to criminal penalties including imprisonment of five (5) years and/or a criminal fine. 18 USC 1960.

**Estimate of Business Volume:**

The law requires a money services business to estimate the volume of its business in the coming year. 31 U.S.C. 5330(b). That estimate must be prepared annually. The estimate is not reported on this form, but must be maintained in the files of the money services business.

**Supporting Documentation:**

A money services business must retain for five (5) years certain information in support of this registration form at a location within the United States. That information includes: a copy of the registration form and, as indicated above, an estimate of the volume of its business in the coming year.

In addition, a money services business must retain as supporting documentation the following information with regard to the ownership or

control of the business: the name and address of any shareholder holding more than 5%; any general partner; any trustee; and/or any director or officer of the business. If the supporting documentation is retained at a location other than the address listed in Part I, enter the appropriate location information in Part V; if not, check the box in Part V.

**Agent Lists:**

A money services business that has agents must prepare and maintain a listing of its agents. That list must be updated annually and retained by the business at the location in the United States reported on the registration form in Part I or Part V, as appropriate. The list should NOT BE FORWARDED with the registration form. The list must include:

- each agent's name;
- each agent's address;
- each agent's telephone number;
- the type of service(s) provided by each agent on behalf of the money services business in Part I;
- a listing of the months in the immediately preceding 12 months in which the gross transaction amount of each agent with respect to financial products/services issued by the money services business in Part I exceeds \$100,000;
- the name and address of any depository institution at which each agent maintains a transaction account for the money services in Item 27 conducted by the agent on behalf of the money services business in Part I;
- the year in which each agent first became an agent of the money services business in Part I; and
- the number of branches or subagents each agent has.

See 31 CFR 103.41(d)(2).

**Note:** Registration with the IRS Detroit Computing Center does not satisfy any state or local licensing or registration requirement.

**Specific Instructions**

**Part I. Registrant Information**

**Items 3 and 4. Organization Name and Doing Business As (DBA).** – Enter the name of the organization and, if applicable, the Doing Business As name. For example, Good Hope Enterprises, Inc., DBA: Joe's Check Cashing. **Items 5, 7, 8 and 9. Address.** – Enter the permanent street address, including zip code, of the registering business. Use the Post Office's two-letter state abbreviation code. A P.O. Box address may only be used if there is no street address.

**Part II. Owner or Controlling Person**

**Items 11, 12, 13, 14, 15, 16, 17, 18, 19, 20 and 21.**

Any person who owns or controls a money services business shares the responsibility for seeing that the business is registered. Only one registration form is required for any business in any registration period. If more than one person owns or controls the business, they may enter into an agreement designating one of them to register the business. The designated owner or controlling person must complete Part II and provide the requested information about himself, herself, or itself. In addition, that person must sign and date the form as indicated in Part VI. Failure by the designated person to register the business does not relieve any other person who owns or controls the business of the liability for failure to register the business.

An "Owner or Controlling person" includes the following:

Registrant Business	Owner or Controlling Person
Sole Proprietorship.....	the individual who owns the business
Partnership.....	a general partner
Trust.....	a trustee
Corporation.....	the largest single shareholder

If two or more persons own equal numbers of shares of a corporation, those persons may enter into an agreement as explained above that one of those persons may register the business.

If the owner or controlling person is a corporation, a duly authorized officer of the owner-corporation may execute the form on behalf of the owner-corporation.

**Public Corporation**

If the registrant business is a public corporation, it is sufficient to write "public corporation" in line 11 of Part II. Where registrant is a public corporation, a duly authorized officer of the registrant may execute the form.

**Item 22. Identification** – Do not provide "other" identification unless no driver's license/state ID, passport or alien registration number is available. "Other" identification includes any official identification that is issued by a governmental authority.

**Part III. Money Services Information**

**Item 23. Where services are offered.** -- Mark the box(es) for any state, territory or district in which the money services business offers services through its branches, its agents, or both. If a service is offered on tribal lands, mark the box for the state, territory or district in which the tribal lands are located.

**Item 24. Number of Branches of Registrant.** -- Enter the number of branches of the money services business at which one or more Money Services Business (MSB) services are offered.

**Item 25. Services Offered by Registrant.** -- The services listed in Items 25a through 25g are MSB services. Mark the box of each MSB service that is offered by the registrant at its branches.

**Item 26. Mobile Operation.** -- If any part of the money services business is conducted as a mobile operation, check yes here. A mobile operation is one based in a vehicle, for example, a check cashing service offered from a truck. For purposes of Item 24, each mobile operation is counted as a separate branch.

**Item 27. Number of Agents.** -- Enter the number of agents that the

registrant has authorized to sell or distribute its MSB services. A bank is not an agent for this purpose. See 31 CFR 103.11(c) and 103.11(uu).

**Part IV Primary Transaction Account**

**Item 28.** -- Mark this box if the money services business (registrant) has more than one primary transaction account. Example: If the registrant is both an issuer of money orders and an issuer of traveler's checks and the registrant has a separate clearing account for money orders and one for traveler's checks, the box should be checked because there is a primary transaction account for money orders and a primary transaction account for traveler's checks.

**Items 29, 30, 31, 32, 33, and 34. Name, Address, and Account Number of Primary Transaction Account.** -- Enter the name and address of the bank or other depository institution where the money services business has its primary transaction account.

If the business has more than one primary transaction account and the box in Item 28 has been checked, enter information about the account with the greatest transaction volume as measured by value in dollars. A transaction account is defined in 12 U.S.C. 461(b)(1)(c).

**Exhibit 19.6** (continued)

Form <b>3520</b> Department of the Treasury Internal Revenue Service	<b>Annual Return To Report Transactions With          Foreign Trusts and Receipt of Certain Foreign Gifts</b> ▶ See separate instructions.	OMB No. 1545-0159 <b>2003</b>
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**Note:** All information must be in English. Show all amounts in U.S. dollars. File a separate Form 3520 for each foreign trust.

For calendar year 2003, or tax year beginning \_\_\_\_\_, 2003, ending \_\_\_\_\_, 20

**A** Check appropriate boxes:  Initial return  Final return  Amended return

**B** Check box that applies to U.S. person filing return:  Individual  Partnership  Corporation  Trust  Executor

**Check all applicable boxes:**

- (a) You are a U.S. transferor who, directly or indirectly, transferred money or other property during the current tax year to a foreign trust, or (b) You held an outstanding obligation of a related foreign trust (or a person related to the trust) issued during the current tax year, that you reported as a "qualified obligation" (defined on page 3 of the instructions) during the current tax year. See the instructions for Part I.
- You are a U.S. owner of all or any portion of a foreign trust at any time during the tax year. See the instructions for Part II.
- (a) You are a U.S. person who, during the current tax year, received a distribution from a foreign trust, or (b) A related foreign trust held an outstanding obligation issued by you (or a person related to you) during the current tax year that you reported as a "qualified obligation" (defined on page 3 of the instructions) during the current tax year. See the instructions for Part III.
- You are a U.S. person who, during the current tax year, received certain gifts or bequests from a foreign person. See the instructions for Part IV.

**Service Center where U.S. person filing this return files its income tax return ▶**

<b>1a</b> Name of U.S. person(s) filing return (see page 5 of instructions)			<b>b</b> Identification number	
<b>c</b> Number, street, and room or suite no. (if a P.O. box, see page 5 of instructions)			<b>d</b> Spouse's identification number	
<b>e</b> City or town	<b>f</b> State or province	<b>g</b> ZIP or postal code	<b>h</b> Country	
<b>2a</b> Name of foreign trust (if applicable)			<b>b</b> Employer identification number (if any)	
<b>c</b> Number, street, and room or suite no. (if a P.O. box, see page 5 of instructions)				
<b>d</b> City or town	<b>e</b> State or province	<b>f</b> ZIP or postal code	<b>g</b> Country	
<b>3</b> Did the foreign trust appoint a U.S. agent (defined on page 4 of the instructions) who can provide the IRS with all relevant trust information? <input type="checkbox"/> Yes <input type="checkbox"/> No If "Yes," complete lines 3a through 3g.				
<b>3a</b> Name of U.S. agent			<b>b</b> Identification number (if any)	
<b>c</b> Number, street, and room or suite no. (if a P.O. box, see page 5 of instructions)				
<b>d</b> City or town	<b>e</b> State or province	<b>f</b> ZIP or postal code	<b>g</b> Country	
<b>4a</b> Name of U.S. decedent (see instr.)	<b>b</b> Address		<b>c</b> TIN of decedent	
<b>d</b> Date of death			<b>e</b> EIN of estate	

Under penalties of perjury, I declare that I have examined this return, including any accompanying reports, schedules, or statements, and to the best of my knowledge and belief, it is true, correct, and complete.

Signature	Title	Date
Preparer's signature	Preparer's SSN or PTIN	Date

**Exhibit 19.7** Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts.



**Part I Transfers by U.S. Persons to a Foreign Trust During the Current Tax Year** (see page 5 of instructions)

**5a** Name of trust creator (if different from line 1a) **b** Address **c** Identification number (if any)

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**6a** Country code of country where trust was created **b** Country code of country whose law governs the trust **c** Date trust was created

---

**7a** Will any person (other than the U.S. transferor or the foreign trust) be treated as the owner of the transferred assets after the transfer?  Yes  No

<b>b</b> Name of other foreign trust owners, if any	<b>(i)</b> Address	<b>(ii)</b> Country of residence	<b>(iv)</b> Identification number, if any	<b>(v)</b> Relevant code section

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**8** Was the transfer a completed gift or bequest? If "Yes," see instructions . . . . .  Yes  No

**9a** Now or in the future, can any part of the income or corpus of the trust benefit any U.S. beneficiary? . . . . .  Yes  No

**b** If "No," could the trust be revised or amended to benefit a U.S. beneficiary? . . . . .  Yes  No

**10** Will you continue to be treated as the owner of the transferred asset(s) after the transfer? . . . . .  Yes  No

**Schedule A—Obligations of a Related Trust** (see page 5 of instructions)

**11a** During the current tax year, did you transfer property (including cash) to a related foreign trust in exchange for an obligation of the trust or an obligation of a person related to the trust? See instructions . . . . .  Yes  No  
If "Yes," complete the rest of Schedule A, as applicable. If "No," go to Schedule B.

**b** Were any of the obligations you received (with respect to a transfer described in 11a above) qualified obligations?  Yes  No  
If "Yes," complete the rest of Schedule A with respect to each qualified obligation.  
If "No," go to Schedule B and, when completing columns (a) through (i) of line 13 with respect to each nonqualified obligation, enter "-0-" in column (h).

<b>(i)</b> Date of transfer giving rise to obligation	<b>(ii)</b> Maximum term	<b>(iii)</b> Yield to maturity	<b>(iv)</b> FMV of obligation

**12** With respect to each qualified obligation you reported on line 11b: Do you agree to extend the period of assessment of any income or transfer tax attributable to the transfer, and any consequential income tax changes for each year that the obligation is outstanding, to a date 3 years after the maturity date of the obligation? . . . . .  Yes  No

**Note:** Generally, you must answer "Yes," if you checked "Yes" to the question on line 11b.

**Schedule B—Gratuitous Transfers** (see page 5 of instructions)

**13** During the current tax year, did you make any transfers (directly or indirectly) to the trust and receive less than FMV, or no consideration at all, for the property transferred? . . . . .  Yes  No  
If "Yes," complete columns (a) through (i) below and the rest of Schedule B, as applicable.  
If "No," go to Schedule C.

<b>(a)</b> Date of transfer	<b>(b)</b> Description of property transferred	<b>(c)</b> FMV of property transferred	<b>(d)</b> U.S. adjusted basis of property transferred	<b>(e)</b> Gain recognized at time of transfer	<b>(f)</b> Excess, if any, of column (c) over the sum of columns (d) and (e)	<b>(g)</b> Description of property received, if any	<b>(h)</b> FMV of property received	<b>(i)</b> Excess of column (c) over column (h)
<b>Totals</b> ▶					\$		\$	

**14** You are required to attach a copy of each sale or loan document entered into in connection with a transfer reported on line 13. If these documents have been attached to a Form 3520 filed within the previous 3 years, attach only relevant updates.

Are you attaching a copy of:

	Yes	No	Attached Previously	Year Attached
<b>a</b> Sale document? . . . . .	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____
<b>b</b> Loan document? . . . . .	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____
<b>c</b> Subsequent variances to original sale or loan documents? . . . . .	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____

Exhibit 19.7 (continued)

**Part I Schedule B—Gratuitous Transfers (Continued)**

**Note:** Complete lines 15 through 18 only if you answered "No" to line 3.

<b>15</b>	<b>(a)</b> Name of beneficiary	<b>(b)</b> Address of beneficiary	<b>(c)</b> U.S. beneficiary?		<b>(d)</b> Identification number, if any
			Yes	No	
<b>16</b>	<b>(a)</b> Name of trustee	<b>(b)</b> Address of trustee			<b>(c)</b> Identification number, if any
<b>17</b>	<b>(a)</b> Name of other persons with trust powers	<b>(b)</b> Address of other persons with trust powers	<b>(c)</b> Description of powers	<b>(d)</b> Identification number, if any	

**18** If you checked "No" on line 3 (or did not complete lines 3a through 3g) you are required to attach a copy of all trust documents as indicated below. If these documents have been attached to a Form 3520-A filed within the previous 3 years, attach only relevant updates.

Are you attaching a copy of:

	Yes	No	Attached Previously	Year Attached
<b>a</b> Summary of all written and oral agreements and understandings relating to the trust?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____
<b>b</b> The trust instrument?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____
<b>c</b> Memoranda or letters of wishes?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____
<b>d</b> Subsequent variances to original trust documents?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____
<b>e</b> Trust financial statements?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____
<b>f</b> Other trust documents?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____

**Schedule C—Qualified Obligations Outstanding in the Current Tax Year** (see page 6 of instructions)

**19** Did you, at any time during the tax year, hold an outstanding obligation of a related foreign trust (or a person related to the trust) that you reported as a "qualified obligation" in the current tax year?  Yes  No  
If "Yes," complete columns (a) through (e) below.

<b>(a)</b> Date of original obligation	<b>(b)</b> Tax year qualified obligation first reported	<b>(c)</b> Amount of principal payments made during the tax year	<b>(d)</b> Amount of interest payments made during the tax year	<b>(e)</b> Does the obligation still meet the criteria for a qualified obligation?	
				Yes	No

Exhibit 19.7 (continued)

**Part II U.S. Owner of a Foreign Trust** (see page 6 of instructions)

<b>20</b>	(a) Name of other foreign trust owners, if any	(b) Address	(c) Country of residence	(d) Identification number, if any	(e) Relevant code section
<b>21</b>	(a) Country code of country where foreign trust was created	(b) Country code of country whose law governs the foreign trust	(c) Date foreign trust was created		
<b>22</b>	Did the foreign trust file Form 3520-A for the current year? . . . . .				<input type="checkbox"/> Yes <input type="checkbox"/> No
If "Yes," attach the Foreign Grantor Trust Owner Statement you received from the foreign trust.					
If "No," to the best of your ability, complete and attach a substitute Form 3520-A for the foreign trust.					
See page 2 of instructions for information on penalties.					
<b>23</b>	Enter the gross value of the portion of the foreign trust that you are treated as owning . . . . .				\$

**Part III Distributions to a U.S. Person From a Foreign Trust During the Current Tax Year** (see page 6 of instructions)

<b>24</b> Cash amounts or FMV of property received, directly or indirectly, during the current tax year, from the foreign trust (exclude loans included on line 25).					
(a) Date of distribution	(b) Description of property received	(c) FMV of property received (determined on date of distribution)	(d) Description of property transferred, if any	(e) FMV of property transferred	(f) Excess of column (c) over column (e)
<b>Totals</b> . . . . .					\$

**25** During the current tax year, did you (or a person related to you) receive a loan from a related foreign trust (including an extension of credit upon the purchase of property from the trust)? . . . . .  Yes  No

If "Yes," complete columns (a) through (g) below for each such loan.

**Note:** The FMV of an obligation (column (f)) is -0- unless it is a "qualified obligation."

(a) FMV of loan proceeds	(b) Date of original loan transaction	(c) Maximum term of repayment of obligation	(d) Interest rate of obligation	(e) Is the obligation a "qualified obligation?"		(f) FMV of obligation	(g) Amount treated as distribution from the trust (subtract column (f) from column (a))
				Yes	No		
<b>Total</b> . . . . .							\$

**26** With respect to each obligation you reported as a "qualified obligation" on line 25: Do you agree to extend the period of assessment of any income or transfer tax attributable to the transaction, and any consequential income tax changes for each year that the obligation is outstanding, to a date 3 years after the maturity date of the obligation? . . . . .  Yes  No

**Note:** Generally, you must answer "Yes" if you checked "Yes" in column (e) of line 25.

**27** Total distributions received during the current tax year. Add line 24, column (f), and line 25, column (g) . . . . . \$

**28** Did the trust, at any time during the tax year, hold an outstanding obligation of yours (or a person related to you) that you reported as a "qualified obligation" in the current tax year? . . . . .  Yes  No

If "Yes," complete columns (a) through (e) below for each obligation.

(a) Date of original loan transaction	(b) Tax year qualified obligation first reported	(c) Amount of principal payments made during the tax year	(d) Amount of interest payments made during the tax year	(e) Does the loan still meet the criteria of a qualified obligation?	
				Yes	No

Exhibit 19.7 (continued)

**Part III Distributions to a U.S. Person From a Foreign Trust During the Current Tax Year (Continued)**

- 29 Did you receive a Foreign Grantor Trust Beneficiary Statement from the foreign trust with respect to a distribution?  Yes  No  
 If "Yes," attach the statement and do not complete the remainder of Part III with respect to that distribution.  
 If "No," complete Schedule A with respect to that distribution. Also complete Schedule C if you enter an amount greater than zero on line 37.
- 30 Did you receive a Foreign Nongrantor Trust Beneficiary Statement from the foreign trust with respect to a distribution?  Yes  No  
 If "Yes," attach the statement and complete either Schedule A or Schedule B below (see page 7 of instructions). Also complete Schedule C if you enter an amount greater than zero on line 37 or line 41.  
 If "No," complete Schedule A with respect to that distribution. Also complete Schedule C if you enter an amount greater than zero on line 37.

**Schedule A—Default Calculation of Trust Distributions (see page 7 of instructions)**

- 31 Enter amount from line 27 . . . . .
- 32 Number of years the trust has been a foreign trust (see instructions). ▶ \_\_\_\_\_
- 33 Enter total distributions received from the foreign trust during the 3 preceding tax years (or the number of years the trust has been a foreign trust, if fewer than 3) . . . . .
- 34 Multiply line 33 by 1.25 . . . . .
- 35 Average distribution. Divide line 34 by 3 (or the number of years the trust has been a foreign trust, if fewer than 3) and enter the result . . . . .
- 36 Amount treated as ordinary income earned in the current year. Enter the smaller of line 31 or line 35 . . . . .
- 37 Amount treated as accumulation distribution. Subtract line 36 from line 31. If -0-, do not complete the rest of Part III
- 38 Applicable number of years of trust. Divide line 32 by 2 and enter the result here ▶ \_\_\_\_\_

**Schedule B—Actual Calculation of Trust Distributions (see page 8 of instructions)**

- 39 Enter amount from line 27 . . . . .
- 40 Amount treated as ordinary income in the current tax year . . . . .
- 41 Amount treated as accumulation distribution. If -0-, do not complete Schedule C, Part III . . . . .
- 42 Amount treated as capital gains in the current tax year . . . . .
- 43 Amount treated as distribution from trust corpus . . . . .
- 44 Enter any other distributed amount received from the foreign trust not included on lines 40, 41, 42, and 43 (attach explanation) . . . . .
- 45 Amount of foreign trust's aggregate undistributed net income . . . . .
- 46 Amount of foreign trust's weighted undistributed net income . . . . .
- 47 Applicable number of years of trust. Divide line 46 by line 45 and enter the result here ▶ \_\_\_\_\_

**Schedule C—Calculation of Interest Charge (see page 8 of instructions)**

- 48 Enter accumulation distribution from line 37 or 41, as applicable . . . . .
- 49 Enter tax on total accumulation distribution from line 28 of Form 4970 . . . . .
- 50 Enter applicable number of years of foreign trust from line 38 or 47, as applicable (round to nearest half-year). ▶ \_\_\_\_\_
- 51 Combined interest rate imposed on the total accumulation distribution (see page 8 of instructions) . . . . .
- 52 Interest charge. Multiply the amount on line 49 by the combined interest rate on line 51 . . . . .
- 53 Tax attributable to accumulation distributions. Add lines 49 and 52. Enter here and as "additional tax" on your income tax return . . . . .

Exhibit 19.7 (continued)

**Part IV U.S. Recipients of Gifts or Bequests Received During the Current Tax Year From Foreign Persons**  
(see page 9 of instructions)

**54** During the current tax year, did you receive more than \$100,000 during the tax year that you treated as gifts or bequests from a nonresident alien or a foreign estate? See instructions regarding related donors . . . . .  **Yes**  **No**  
If "Yes," complete columns (a) through (c) with respect to each such gift or bequest in excess of \$5,000. If more space is needed, attach schedule.

(a) Date of gift or bequest	(b) Description of property received	(c) FMV of property received
<b>Total</b> . . . . . ▶		\$

**55** During the current tax year, did you receive more than \$11,827 that you treated as gifts from a foreign corporation or a foreign partnership? See instructions regarding related donors . . . . .  **Yes**  **No**  
If "Yes," complete columns (a) through (g) with respect to each such gift. If more space is needed, attach schedule.

(a) Date of gift	(b) Name of donor	(c) Address of donor	(d) Identification number, if any

(e) Check the box that applies to the foreign donor		(f) Description of property received	(g) FMV of property received
Corporation	Partnership		

**56** Do you have any reason to believe that the foreign donor, in making any gift or bequest described in lines 54 and 55, was acting as a nominee or intermediary for any other person? If "Yes," see instructions. . . . .  **Yes**  **No**



Exhibit 19.7 (continued)

2003


 Department of the Treasury  
 Internal Revenue Service

# Instructions for Form 3520

## Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts

Section references are to the Internal Revenue Code unless otherwise noted.

### A Change To Note

A U.S. citizen or resident alien holding an interest in a Canadian registered retirement savings plan (RRSP) or a Canadian registered retirement income fund (RRIF) who is subject to the simplified reporting rules described in Notice 2003-75, 2003-50 I.R.B. 1204, with respect to the RRSP or RRIF is relieved of any obligation to file Form 3520 to report transfers to, the ownership of, and distributions from the RRSP or RRIF. It is anticipated that most, if not all, such U.S. citizens or resident aliens will be subject to the simplified reporting rules described in Notice 2003-75.

### How To Access the Internal Revenue Bulletin (I.R.B.)

You can access the I.R.B. on the internet at [www.irs.gov](http://www.irs.gov) (post-1995 Bulletins only). Under contents, select **Businesses**. Under topics, select **More Topics**. Then select **Internal Revenue Bulletins**.

## General Instructions

### Purpose of Form

U.S. persons file Form 3520 to report:

- Certain transactions with foreign trusts and
- Receipt of certain large gifts or bequests from certain foreign persons.

A separate Form 3520 must be filed for transactions with **each** foreign trust.

### Who Must File

File Form 3520 if:

1. You are the **responsible party** for reporting a **reportable event** that occurred during the current tax year, or you held an outstanding obligation of a related foreign trust (or a person related to the trust) that you treated as a **qualified obligation** during the current tax year. **Responsible party, reportable event, and qualified obligation** are defined on pages 3 and 4.

Complete the identifying information on page 1 of the form and the relevant portions of Part I. See the instructions for Part I.

2. You are a **U.S. person** who, during the current tax year, is treated as the owner of any part of the assets of a foreign trust under the grantor trust rules.

Complete the identifying information on page 1 of the form and Part II. See the instructions for Part II.

3. You are a **U.S. person** who received (directly or indirectly) a distribution from a foreign trust during the current tax year or a related foreign trust held an outstanding obligation issued by you (or a person related

to you) that you treated as a **qualified obligation** (defined on page 3) during the current tax year.

Complete the identifying information on page 1 of the form and Part III. See the instructions for Part III.

4. You are a **U.S. person** who, during the current tax year, received either:

- a. More than \$100,000 from a nonresident alien individual or a foreign estate (including foreign persons related to that nonresident alien individual or foreign estate) that you treated as gifts or bequests or
- b. More than \$11,827 from foreign corporations or foreign partnerships (including foreign persons related to such foreign corporations or foreign partnerships) that you treated as gifts.

Complete the identifying information on page 1 of the form and Part IV. See the instructions for Part IV.

**Note:** You may also be required to file **Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts**.

### Exceptions To Filing

Form 3520 does not have to be filed to report the following transactions.

- Transfers to foreign trusts described in sections 402(b), 404(a)(4), or 404A.
- Most fair market value (FMV) transfers by a U.S. person to a foreign trust. However, some FMV transfers must nevertheless be reported on Form 3520 (e.g., transfers in exchange for obligations that are treated as qualified obligations, transfers of appreciated property to a foreign trust for which the U.S. transferor does not immediately recognize all of the gain on the property transferred, transfers involving a U.S. transferor that is related to the foreign trust). See Section III of Notice 97-34, 1997-25 I.R.B. 22.
- Transfers to foreign trusts that have a current determination letter from the IRS recognizing their status as exempt from income taxation under section 501(c)(3).
- Transfers to, ownership of, and distributions from a Canadian RRSP or RRIF, where the U.S. citizen or resident alien holding an interest in such RRSP or RRIF is subject to the simplified reporting rules described in Notice 2003-75 with respect to the RRSP or RRIF.
- Distributions from foreign trusts that are taxable as compensation for services rendered (within the meaning of section 672(f)(2)(B) and its regulations), so long as the recipient reports the distribution as compensation income on its applicable Federal income tax return.
- Distributions from foreign trusts to domestic trusts that have a current determination letter from the IRS recognizing their status as exempt from income taxation under section 501(c)(3).
- Domestic trusts that become foreign trusts to the extent the trust is treated as owned by a foreign person, after application of section 672(f).

Cat. No. 230681

## Joint Returns

Two transferors or grantors of the same foreign trust, or two U.S. beneficiaries of the same foreign trust, may file a joint Form 3520, but only if they file a joint income tax return.

## When and Where To File

In general, Form 3520 is due on the date that your income tax return is due, including extensions. Send Form 3520 to the Internal Revenue Service Center, Philadelphia, PA 19255.

Form 3520 must have all required attachments to be considered complete.

**Note:** *If a complete Form 3520 is not filed by the due date, including extensions, the time for assessment of any tax imposed with respect to any event or period to which the information required to be reported in Parts I through III of such Form 3520 relates, will not expire before the date that is 3 years after the date on which the required information is reported. See section 6501(c)(8).*

## Who Must Sign

If the return is filed by:

- An individual or a fiduciary, it must be signed and dated by that individual or fiduciary.
- A partnership, it must be signed and dated by a general partner or limited liability company member.
- A corporation, it must be signed and dated by the president, vice president, treasurer, assistant treasurer, chief accounting officer, or any other corporate officer (such as a tax officer) who is authorized to sign.

The paid preparer must complete the required preparer information and:

- Sign the return in the space provided for the preparer's signature.
- Give a copy of the return to the filer.

## Inconsistent Treatment of Items

The U.S. beneficiary and U.S. owner's tax return must be consistent with the **Form 3520-A**, Annual Information Return of Foreign Trust With a U.S. Owner, filed by the foreign trust unless you report the inconsistency to the IRS. If you are treating items on your tax return differently from the way the foreign trust treated them on its return, file **Form 8082**, Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR). See Form 8082 for more details.

## Penalties

A penalty generally applies if Form 3520 is not timely filed or if the information is incomplete or incorrect. Generally, the penalty is:

1. 35% of the gross value of any property transferred to a foreign trust for failure by a U.S. transferor to report the transfer,
2. 35% of the gross value of the distributions received from a foreign trust for failure by a U.S. person to report receipt of the distribution, or
3. 5% of the amount of certain foreign gifts for each month for which the failure to report continues (not to exceed a total of 25%). See section 6039F(c).

If a foreign trust has a U.S. owner and the trust fails to file the required annual reports on trust activities and income, the U.S. owner is subject to a penalty equal to 5% of the gross value of the portion of the trust's assets

treated as owned by the U.S. person (the gross reportable amount). See Form 3520-A.

Additional penalties may be imposed if noncompliance continues after the IRS mails a notice of failure to comply with required reporting. However, this penalty may not exceed the gross reportable amount. Also, penalties will only be imposed to the extent that the transaction is not reported. For example, if a U.S. person transfers property worth \$1 million to a foreign trust but only reports \$400,000 of that amount, penalties could only be imposed on the unreported \$600,000.

For more information, see section 6677.

**Reasonable cause.** No penalties will be imposed if the taxpayer can demonstrate that the failure to comply was due to reasonable cause and not willful neglect.

**Note.** *The fact that a foreign country would impose penalties for disclosing the required information is not reasonable cause. Similarly, reluctance on the part of a foreign fiduciary or provisions in the trust instrument that prevent the disclosure of required information is not reasonable cause.*

## Definitions

### Distribution

A **distribution** is any gratuitous transfer of money or other property from a trust, whether or not the trust is treated as owned by another person under the grantor trust rules, and without regard to whether the recipient is designated as a beneficiary by the terms of the trust. A distribution includes the receipt of trust corpus and the receipt of a gift or bequest described in section 663(a).

A distribution also includes constructive transfers from a trust. For example, if charges you make on a credit card are paid by a foreign trust or guaranteed or secured by the assets of a foreign trust, the amount charged will be treated as a distribution to you by the foreign trust. Similarly, if you write checks on a foreign trust's bank account, the amount will be treated as a distribution.

Also, if you receive a payment from a foreign trust in exchange for property transferred to the trust or services rendered to the trust, and the FMV of the payment received exceeds the FMV of the property transferred or services rendered, the excess will be treated as a distribution to you.

### Examples

1. If you sell stock with an FMV of \$100 to a foreign trust and receive \$150 in exchange, you have received a distribution of \$50.
2. If you receive \$100 from the trust for services performed by you for the trust, and the services have an FMV of \$20, you have received a distribution of \$80.

See the instructions for Part III, line 25, on page 7, for another example of a distribution from a foreign trust.

## Foreign Trust and Domestic Trust

A **foreign trust** is any trust other than a domestic trust.

A **domestic trust** is any trust if:

1. A court within the United States is able to exercise primary supervision over the administration of the trust and
2. One or more U.S. persons have the authority to control all substantial decisions of the trust.

### Grantor

A **grantor** includes any person who creates a trust or directly or indirectly makes a gratuitous transfer of cash or other property to a trust. A grantor includes any person treated as the owner of any part of a foreign trust's assets under sections 671 through 679, excluding section 678.

**Note:** *If a partnership or corporation makes a gratuitous transfer to a trust, the partners or shareholders are generally treated as the grantors of the trust, unless the partnership or corporation made the transfer for a business purpose of the partnership or corporation.*

*If a trust makes a gratuitous transfer to another trust, the grantor of the transferor trust is treated as the grantor of the transferee trust, except that if a person with a general power of appointment over the transferor trust exercises that power in favor of another trust, such person is treated as the grantor of the transferee trust, even if the grantor of the transferor trust is treated as the owner of the transferor trust.*

### Grantor Trust

A **grantor trust** is any trust to the extent that the assets of the trust are treated as owned by a person other than the trust. See the grantor trust rules in sections 671 through 679. A part of the trust may be treated as a grantor trust to the extent that only a portion of the trust assets are owned by a person other than the trust.

### Gratuitous Transfer

A **gratuitous transfer** to a foreign trust is any transfer to the trust other than (a) a transfer for FMV or (b) a distribution to the trust with respect to an interest held by the trust (i) in an entity other than a trust (e.g., a corporation or a partnership) or (ii) in an investment trust described in Regulations section 301.7701-4(c), a liquidating trust described in Regulations section 301.7701-4(d), or an environmental remediation trust described in Regulations section 301.7701-4(e).

A transfer of property to a trust may be considered a gratuitous transfer without regard to whether the transfer is a gift for gift tax purposes (see Chapter 12 of Subtitle B of the Code).

For purposes of this determination, if a U.S. person contributes property to a trust in exchange for any type of interest in the trust, such interest in the trust will be disregarded in determining whether FMV has been received. In addition, a U.S. person will not be treated as making a transfer for FMV merely because the transferor is deemed to recognize gain on the transaction.

If you transfer property to a foreign trust in exchange for an obligation of the trust (or a person related to the trust), it will be a gratuitous transfer unless the obligation is a qualified obligation. Obligation and qualified obligation are defined below.

### Gross Reportable Amount

**Gross reportable amount is:**

- The gross value of property involved in the creation of a foreign trust or the transfer of property to a foreign trust (including a transfer by reason of death);
- The gross value of any portion of a foreign trust treated as owned by a U.S. person under the grantor trust rules or any part of a foreign trust that is included in the gross estate of a U.S. citizen or resident;
- The gross value of assets deemed transferred at the time a domestic trust to which a U.S. citizen or resident

previously transferred property becomes a foreign trust, provided such U.S. citizen or resident is alive at the time the trust becomes a foreign trust (see section 679(a)(5)); or

- The gross amount of distributions received from a foreign trust.

### Gross Value

**Gross value** is the FMV of property as determined under section 2031 and its regulations as if the owner had died on the valuation date. Although formal appraisals are not generally required, you should keep contemporaneous records of how you arrived at your good faith estimate.

### Guarantee

A **guarantee:**

- Includes any arrangement under which a person, directly or indirectly, assures, on a conditional or unconditional basis, the payment of another's obligation;
- Encompasses any form of credit support, and includes a commitment to make a capital contribution to the debtor or otherwise maintain its financial viability; or
- Includes an arrangement reflected in a "comfort letter," regardless of whether the arrangement gives rise to a legally enforceable obligation. If an arrangement is contingent upon the occurrence of an event, in determining whether the arrangement is a guarantee, you must assume that the event has occurred.

### Nongrantor Trust

A **nongrantor trust** is any trust to the extent that the assets of the trust are not treated as owned by a person other than the trust. Thus, a nongrantor trust is treated as a taxable entity. A trust may be treated as a nongrantor trust with respect to only a portion of the trust assets. See **Grantor Trust** above.

### Obligation

An **obligation** includes any bond, note, debenture, certificate, bill receivable, account receivable, note receivable, open account, or other evidence of indebtedness, and, to the extent not previously described, any annuity contract.

### Owner

An **owner** of a foreign trust is the person that is treated as owning any of the assets of a foreign trust under the grantor trust rules.

### Property

**Property** means any property, whether tangible or intangible, including cash.

### Qualified Obligation

A **qualified obligation**, for purposes of this form, is any obligation only if:

1. The obligation is reduced to writing by an express written agreement;
2. The term of the obligation does not exceed 5 years (including options to renew and rollovers) and it is repaid within the 5-year term;
3. All payments on the obligation are denominated in U.S. dollars;
4. The yield to maturity of the obligation is not less than 100% of the applicable Federal rate under section 1274(d) for the day on which the obligation is issued and not greater than 130% of the applicable Federal rate;
5. The U.S. person agrees to extend the period for assessment of any income or transfer tax attributable to



the transfer and any consequential income tax changes for each year that the obligation is outstanding, to a date not earlier than 3 years after the maturity date of the obligation, unless the maturity date of the obligation does not extend beyond the end of the U.S. person's tax year and is paid within such period (this is done on Part I, Schedule A, and Part III, as applicable); and

6. The U.S. person reports the status of the obligation, including principal and interest payments, on Part I, Schedule C, and Part III, as applicable, for each year that the obligation is outstanding.

### Related Person

A **related person** generally includes any person who is related to you for purposes of section 267 and 707(b). This includes, but is not limited to:

- A member of your family—your brothers and sisters, half-brothers and half-sisters, spouse, ancestors (parents, grandparents, etc.), lineal descendants (children, grandchildren, etc.), and the spouses of any of these persons.
- A corporation in which you, directly or indirectly, own more than 50% in value of the outstanding stock.

See section 643(j)(2)(B) and the regulations under sections 267 and 707(b).

**Person related to a foreign trust.** A person is related to a foreign trust if such person, without regard to the transfer at issue, is a grantor of the trust, a beneficiary of the trust, or is related to any grantor or beneficiary of the trust. See the definition of **related person** above.

### Reportable Event

A **reportable event** includes:

1. The creation of a foreign trust by a U.S. person.
2. The transfer of any money or property, directly or indirectly, to a foreign trust by a U.S. person, including a transfer by reason of death. This includes transfers that are deemed to have occurred under sections 679(a)(4) and (5).
3. The death of a citizen or resident of the United States if:
  - The decedent was treated as the owner of any portion of a foreign trust under the grantor trust rules or
  - Any portion of a foreign trust was included in the gross estate of the decedent.

### Responsible Party

**Responsible party** means:

- The grantor in the case of the creation of an inter vivos trust,
- The transferor, in the case of a **reportable event** (defined above) other than a transfer by reason of death, or
- The executor of the decedent's estate in any other case.

### U.S. Agent

A **U.S. agent** is a **U.S. person** (defined below) that has a binding contract with a foreign trust that allows the U.S. person to act as the trust's authorized U.S. agent in applying sections 7602, 7603, and 7604 with respect to:

- Any request by the IRS to examine records or produce testimony related to the proper U.S. tax treatment of amounts distributed, or required to be taken into account under the grantor trust rules, with respect to a foreign trust or
- Any summons by the IRS for such records or testimony.

A U.S. grantor, a U.S. beneficiary, or a domestic corporation controlled by the grantor or beneficiary may act as a U.S. agent. However, you may not treat the foreign trust as having a U.S. agent unless you enter the name, address, and taxpayer identification number of the U.S. agent on lines 3a through 3g. If the person identified as the U.S. agent does not produce records or testimony when requested or summoned by the IRS, the IRS may redetermine the tax consequences of your transactions with the trust and impose appropriate penalties under section 6677.

The agency relationship must be established by the time the U.S. person files Form 3520 for the relevant tax year and must continue as long as the statute of limitations remains open for the relevant tax year. If the agent resigns, liquidates, or its responsibility as an agent of the trust is terminated, see Section IV(B) of Notice 97-34.

### U.S. Beneficiary

A **U.S. beneficiary** generally includes any U.S. person that could possibly benefit (directly or indirectly) from the trust (including an amended trust) at any time, whether or not the person is named in the trust instrument as a beneficiary and whether or not the person can receive a distribution from the trust in the current year. In addition, a U.S. beneficiary includes:

- A foreign corporation that is a controlled foreign corporation (as defined in section 957(a)),
- A foreign partnership if a U.S. person is a partner of the partnership, and
- A foreign estate or trust if the estate or trust has a U.S. beneficiary.

A foreign trust will be treated as having a U.S. beneficiary unless the terms of the trust instrument specifically prohibit any distribution of income or corpus to a U.S. person at any time, even after the death of the U.S. transferor, and the trust cannot be amended or revised to allow such a distribution.

### U.S. Person

A **U.S. person** is:

- A citizen or resident alien of the United States (see **Pub. 519, U.S. Tax Guide for Aliens**, for guidance on determining resident alien status),
- A domestic partnership,
- A domestic corporation,
- Any estate (other than a foreign estate, within the meaning of section 7701(a)(31)(A)), and
- Any domestic trust (defined on page 2).

### U.S. Transferor

A **U.S. transferor** is any U.S. person who:

1. Creates or settles a foreign trust.
2. Directly or indirectly transfers money or property to a foreign trust. This includes a U.S. citizen or resident who has made a deemed transfer under section 679(a)(4) or a U.S. resident who has made a deemed transfer under section 679(a)(5).
3. Makes a sale to a foreign trust if the sale was at other than arm's-length terms or was to a related foreign trust, or makes (or guarantees) a loan to a related foreign trust.
4. Is the executor of the estate of a U.S. person and:
  - a. The decedent made a testamentary transfer (a transfer by reason of death) to a foreign trust,

- b. Immediately prior to death, the decedent was treated as the owner of any portion of a foreign trust under the grantor trust rules, or
- c. Any portion of a foreign trust's assets were included in the estate of the decedent.

Generally, the person defined as the transferor is the **responsible party** (defined on page 4) who must ensure that required information be provided or pay appropriate penalties.

## Specific Instructions

### Period Covered

File the 2003 return for calendar year 2003 and fiscal years that begin in 2003 and end in 2004. For a fiscal year, fill in the tax year space at the top of the form.

### Item A—Initial Return, Final Return, Amended Return

**Initial return.** If this is the first return you are filing concerning the foreign trust identified, check the "Initial return" box.

**Final return.** If no further returns for transactions with the foreign trust are required, check the "Final return" box.

**Example.** If you annually filed Part II, Form 3520, because you were the owner of the trust for U.S. income tax purposes and the trust has terminated within the tax year, that year's return would be a final return with respect to that foreign trust.

**Amended return.** If this Form 3520 is filed to amend a Form 3520 that you previously filed, check the "Amended return" box.

### Identifying Information

**Identification numbers.** Use social security numbers or individual taxpayer identification numbers to identify individuals. Use employer identification numbers to identify estates, trusts, partnerships, and corporations.

**Address.** Include the suite, room, or other unit number after the street address. If the Post Office does not deliver mail to the street address and the U.S. person has a P.O. box, show the box number instead.

**Foreign address.** Do not abbreviate the country name.

**Line 1.** This line identifies the U.S. person that is filing Form 3520. If you and your spouse are both making transfers to the same trust and you file joint returns, you may file only one Form 3520. Put the names and taxpayer identification numbers in the same order as they appear on your Form 1040.

**Line 4.** If you are the executor of the estate of a U.S. citizen or resident, you must identify the decedent on this line.

### Part I—Transfers by U.S. Persons to a Foreign Trust During the Current Tax Year

Complete Part I for information on a **reportable event** (defined on page 4).

**Note:** Although the basic reporting requirements for Form 3520 are contained in section 6048 (and are

clarified by Notice 97-34), the reporting requirements have been clarified by the regulations under sections 679 and 684. Accordingly, the regulations under sections 679 and 684 should be referred to for additional clarification for transfers that are required to be reported in Part I of Form 3520.

**Line 5.** If you are not the trust creator, enter the name of the person that created or originally settled the foreign trust.

**Line 6.** See the list of country codes on pages 11 and 12. If the country is not included in the list, enter "OC" for "other country" and enter the country's name.

**Lines 7, 8, and 10.** If you are reporting multiple transfers to a single foreign trust and the answers to lines 7, 8, or 10 are different for various transfers, complete a separate line for each transfer on duplicate copies of the relevant pages of the form.

**Line 7a.** If "Yes," you must comply with the reporting requirements that would apply to a direct transfer to that other person. For example, if that other person is a foreign partnership, you must comply with the reporting requirements for transfers to foreign partnerships (see **Form 8865**, Return of U.S. Persons With Respect to Certain Foreign Partnerships).

**Line 8.** If the transfer was a completed gift (see Regulations section 25.2511-2) or bequest, you may have to file **Form 706**, United States Estate (and Generation-Skipping Transfer) Tax Return, or **Form 709**, United States Gift (and Generation-Skipping Transfer) Tax Return.

**Line 9.** See definition of **U.S. beneficiary** on page 4.

**Line 10.** If you are treated as the owner of any portion of the foreign trust under the grantor trust rules, answer "Yes" to this question and complete Part II.

### Schedule A—Obligations of a Related Trust

**Line 11a.** The FMV of an obligation of the trust (or an obligation of another person related to the trust) that you receive in exchange for the transferred property equals zero, unless the obligation meets the requirements of a qualified obligation. See page 3 for the definitions of **obligation** and **qualified obligation**. See page 4 for the definition of **person related to a foreign trust**.

**Lines 12 and 26.** If you answered "Yes" to the question on line 11b (line 25, column (e)) with respect to any obligation, you generally must answer "Yes" to the question on line 12 (line 26). By so doing, you agree to extend the period of assessment of any income or transfer tax attributable to the transfer and any consequential income tax changes for each year that the obligation is outstanding. This form will be deemed to be agreed upon and executed by the IRS for purposes of Regulations section 301.6501(c)-1(d).

If you answer "No" to the question on line 12 (line 26), you generally may not treat an obligation as a qualified obligation on line 11b (line 25, column (e)). The one exception to this is if the maturity date of the obligation does not extend beyond the end of your tax year for which you are reporting and such obligation is paid within that tax year.

### Schedule B—Gratuitous Transfers

Complete the applicable portions of Schedule B with respect to all **reportable events** (as defined on page 4) that took place during the current tax year.

**Line 13**

- In your description, indicate whether the property is tangible or intangible.
- You may aggregate transfers of cash during the year on a single line of line 13.
- If there is not enough space on the form, please attach a statement.
- For transfers reported on attachments, you must enter "Attachment" on one of the lines in column (b), and enter the total amount of transfers reported on the attachment on line 13, columns (c), (d), (e), (f), (h), and (i).

**Note:** Penalties may be imposed for failure to report all required information. See Item 1 of **Penalties** on page 2.

**Line 13, column (e).** Only include gain that is immediately recognized at the time of the transfer.

**Note:** For any transfer by a U.S. person to a foreign nongrantor trust after August 4, 1997, the transfer is treated as a sale or exchange and the transferor must recognize as a gain the excess of the FMV of the transferred property over its adjusted basis. Although the gain is not recognized on Form 3520, it must be reported on the appropriate form or schedule of the transferor's income tax return. See section 684.

**Line 13, column (f).** Generally, if the reported transaction is a sale, you should report the gain on the appropriate form or schedule of your income tax return.

**Line 15.** Enter the name, address, whether the person is a U.S. beneficiary (defined on page 4), and taxpayer identification number, if any, of all reportable beneficiaries. Include specified beneficiaries, classes of discretionary beneficiaries, and names or classes of any beneficiaries that could be named as additional beneficiaries. If there is not enough space on the form, please attach a statement.

**Line 17.** Enter the name, address, and taxpayer identification number (if any) of any person, other than those listed on line 16, that has significant powers over the trust (e.g., "protectors," "enforcers," any person that must approve trustee decisions, or otherwise direct trustees, any person with a power of appointment, any person with powers to remove or appoint trustees, etc.). Include a description of each person's powers. If there is not enough space, attach a statement.

**Line 18.** If you checked "No" on line 3 (or you did not complete lines 3a through 3g) attach:

- A summary of the terms of the trust that includes a summary of any oral agreements or understandings you have with the trustee, whether or not legally enforceable.
- A copy of all trust documents (and any revisions), including the trust instrument, any memoranda of wishes prepared by the trustees summarizing the settlor's wishes, any letter of wishes prepared by the settlor summarizing his or her wishes, and any similar documents.
- A copy of the trust's financial statements, including a balance sheet and an income statement similar to those shown on Form 3520-A. These financial statements must reasonably reflect the trust's accumulated income under U.S. income tax principles. For example, the statements must not treat capital gains as additions to trust corpus.

### **Schedule C—Qualified Obligations Outstanding in the Current Tax Year**

**Line 19.** Provide information on the status of outstanding obligations of the foreign trust (or person related to the foreign trust) that you reported as a qualified obligation in the current tax year. This

information is required in order to retain the obligation's status as a qualified obligation. If relevant, attach a statement describing any changes in the terms of the qualified obligation.

If the obligation fails to retain the status of a qualified obligation, you will be treated as having made a gratuitous transfer to the foreign trust, which must be reported on Schedule B, Part I. See Section III(C)(2) of Notice 97-34.

### **Part II—U.S. Owner of a Foreign Trust**

Complete Part II if you are considered the owner of any assets of a foreign trust under the grantor trust rules during the tax year. You are required to enter a taxpayer identification number for such foreign trust on line 2b.

**Line 20.** Enter information regarding any person other than yourself who is considered the owner of any portion of the trust under the grantor trust rules. Also, enter in column (e) the specific Code section that causes that person to be considered an owner for U.S. income tax purposes. See the grantor trust rules under sections 671 through 679.

**Line 21.** See the list of country codes on pages 11 and 12. If the country is not included in the list, enter "OC" for "other country" and the country's name.

**Line 22.** If "Yes," the copy of the Foreign Grantor Trust Owner Statement (page 3 of Form 3520-A) should show the amount of the foreign trust's income that is attributable to you for U.S. income tax purposes. See Section IV of Notice 97-34.

If "No," you may be liable for a penalty of 5% of the trust assets that you are treated as owning, plus additional penalties for continuing failure to file after notice by the IRS. See section 6677. Also see **Penalties** on page 2.

**Line 23.** Enter the FMV of the trust assets that you are treated as owning. Include all assets at FMV as of the end of the tax year. For this purpose, disregard all liabilities. The trust should send you this information in connection with its Form 3520-A. If you did not receive such information (line 9 of the Foreign Grantor Trust Owner Statement) from the trust, complete line 23 to the best of your ability. At a minimum, include the value of all assets that you have transferred to the trust. Also use Form 8082 to notify the IRS that you did not receive a Foreign Grantor Trust Owner Statement. However, filing Form 8082 does not relieve you of any penalties that may be imposed under section 6677. See **Penalties** on page 2.

### **Part III—Distributions to a U.S. Person From a Foreign Trust During the Current Tax Year**

If you received an amount from a portion of a foreign trust of which you are treated as the owner and you have correctly reported any information required on Part II and the trust has filed a Form 3520-A with the IRS, do not separately disclose distributions again in Part III. If you received an amount from a foreign trust that would require a report under both Parts III and IV (gifts and bequests) of Form 3520, report the amount only in Part III.

**Line 24.** Report any cash or other property that you received (actually or constructively, directly or indirectly) during the current tax year, from a foreign trust, whether

or not taxable, unless the amount is a loan to you from the trust that must be reported on line 25. For example, if you are a partner in a partnership that receives a distribution from a foreign trust, you must report your allocable share of such payment as an indirect distribution from the trust.

**Line 24, column (c).** The filer is permitted to enter the basis of the property in the hands of the beneficiary (as determined under section 643(e)(1)), if lower than the FMV of the property, but only if the taxpayer is not required to complete Schedule A (lines 31 through 38) due to lack of documentation. For these purposes, lack of documentation refers to a situation in which the filer checked "No" on line 29 or 30 because (a) the beneficiary did not receive a Foreign Grantor Trust Beneficiary Statement or a Foreign Nongrantor Trust Beneficiary Statement from the trust or (b) such statement did not contain all six of the items specified under the instructions for line 29 or line 30 on this page.

**Line 25.** If you, or a person related to you, received a loan from a related foreign trust, it will be treated as a distribution to you unless the obligation you issued in exchange is a qualified obligation.

For this purpose, a loan to you by an unrelated third party that is guaranteed by a foreign trust is generally treated as a loan from the trust.

**Line 25, column (e).** Answer "Yes" if your obligation given in exchange for the loan is a **qualified obligation** (defined on page 3).

**Line 26.** See **Lines 12 and 26** on page 5.

**Line 27.** Penalties may be imposed for failure to accurately report all distributions received during the current tax year. See item 2 of **Penalties** on page 2.

**Line 28.** Provide information on the status of any outstanding obligation to the foreign trust that you reported as a qualified obligation in the current tax year. This information is required in order to retain the obligation's status as a qualified obligation. If relevant, attach a statement describing any changes to the terms of the qualified obligation. If the obligation fails to retain the status of a qualified obligation, you will be treated as having received a distribution from the foreign trust, which must be reported as such on line 25. See Section V(A) of Notice 97-34.

**Lines 29 and 30.** If any of the six items required for the Foreign Grantor Trust Beneficiary Statement (see **Line 29** below) or for the Foreign Nongrantor Trust Beneficiary Statement (see **Line 30** below) is missing, you must check "No" on line 29 or line 30, as applicable.

Also, if you answer "Yes" to line 29 or line 30, and the foreign trust or U.S. agent does not produce records or testimony when requested or summoned by the IRS, the IRS may redetermine the tax consequences of your transactions with the trust and impose appropriate penalties under section 6677.

**Line 29.** If "Yes," attach the Foreign Grantor Trust Beneficiary Statement (page 4 of Form 3520-A) from the foreign trust and do not complete the rest of Part III with respect to the distribution. If a U.S. beneficiary receives a complete Foreign Grantor Trust Beneficiary Statement with respect to a distribution during the tax year, the beneficiary should treat the distribution for income tax purposes as if it came directly from the owner. For example, if the distribution is a gift, the beneficiary should not include the distribution in gross income.

In addition to basic identifying information (i.e., name, address, TIN, etc.) about the foreign trust and its trustee, this statement must contain these items:

1. The first and last day of the tax year of the foreign trust to which this statement applies.
2. An explanation of the facts necessary to establish that the foreign trust should be treated for U.S. tax purposes as owned by another person. (The explanation should identify the Code section that treats the trust as owned by another person.)
3. A statement identifying whether the owner of the trust is an individual, corporation, or partnership.
4. A description of property (including cash) distributed or deemed distributed to the U.S. person during the tax year, and the FMV of the property distributed.
5. A statement that the trust will permit either the IRS or the U.S. beneficiary to inspect and copy the trust's permanent books of account, records, and such other documents that are necessary to establish that the trust should be treated for U.S. tax purposes as owned by another person. This statement is not necessary if the trust has appointed a U.S. agent.
6. A statement as to whether the foreign trust has appointed a **U.S. agent** (defined on page 4). If the trust has a U.S. agent, include the name, address, and taxpayer identification number of the agent.

**Line 30.** If "Yes," attach the Foreign Nongrantor Trust Beneficiary Statement from the foreign trust. A Foreign Nongrantor Trust Beneficiary Statement must include the following items:

1. An explanation of the appropriate U.S. tax treatment of any distribution or deemed distribution for U.S. tax purposes, or sufficient information to enable the U.S. beneficiary to establish the appropriate treatment of any distribution or deemed distribution for U.S. tax purposes.
2. A statement identifying whether any grantor of the trust is a partnership or a foreign corporation. If so, attach an explanation of the relevant facts.
3. A statement that the trust will permit either the IRS or the U.S. beneficiary to inspect and copy the trust's permanent books of account, records, and such other documents that are necessary to establish the appropriate treatment of any distribution or deemed distribution for U.S. tax purposes. This statement is not necessary if the trust has appointed a U.S. agent.
4. The Foreign Nongrantor Trust Beneficiary Statement must also include items 1, 4, and 6, as listed for line 29 above as well as basic identifying information (e.g., name, address, TIN, etc.) about the foreign trust and its trustee.

### Schedule A—Default Calculation of Trust Distributions

If you answered "Yes" to line 30, you may complete either Schedule A or Schedule B. Generally, however, if you complete Schedule A in the current year (or did so in the prior years), you must continue to complete Schedule A for all future years, even if you are able to answer "Yes" to line 30 in that future year. (The only exception to this consistency rule is that you may use Schedule B in the year that a trust terminates, but only if you are able to answer "Yes" to line 30 in the year of termination.)

**Line 32.** To the best of your knowledge, state the number of years the trust has been in existence as a foreign trust and attach an explanation of your basis for

this statement. Consider any portion of a year to be a complete year. If this is the first year that the trust has been a foreign trust, do not complete the rest of Part III (you do not have an accumulation distribution).

**Line 33.** Enter the total amount of distributions that you received during the 3 preceding tax years (or the number of years the trust has been a foreign trust, if less than 3). For example, if a trust distributed \$50 in year 1, \$120 in year 2, and \$150 in year 3, the amount reported on line 33 would be \$320 (\$50 + \$120 + \$150).

**Line 35.** Divide line 34 by 3 (or the number of years the trust has been a foreign trust if fewer than 3). Consider any portion of a year to be a complete year. For example, a foreign trust created on July 1, 2002, would be treated on a 2004 calendar year return as having 2 preceding years (2002 and 2003). In this case, you would calculate the amount on line 35 by dividing line 34 by 2. Do not disregard tax years in which no distributions were made. The IRS will consider your proof of these prior distributions as adequate records to demonstrate that any distribution up to the amount on line 31 is not an accumulation distribution in the current tax year.

**Line 36.** Enter this amount as ordinary income on your tax return. Report this amount on the appropriate schedule of your tax return (e.g., Schedule E (Form 1040), Part III).

**Note:** If there is an amount on line 37, you must also complete line 38 and **Schedule C—Calculation of Interest Charge**, to determine the amount of any interest charge you may owe.

**Schedule B—Actual Calculation of Trust Distributions**

You may only use Schedule B if:

- You answered “Yes” to line 30,
- You attach a copy of the Foreign Nongrantor Trust Beneficiary Statement to this return, and
- You have never before used Schedule A for this foreign trust or this foreign trust terminated during the tax year.

**Line 40.** Enter the amount received by you from the foreign trust that is treated as ordinary income of the trust in the current tax year. Ordinary income is all income that is not capital gains. Report this amount on the appropriate schedule of your tax return (e.g., Schedule E (Form 1040), Part III).

**Line 42.** Enter the amount received by you from the foreign trust that is treated as capital gain income of that trust in the current tax year. Report this amount on the appropriate schedule of your tax return (e.g., Schedule D (Form 1040)).

**Line 45.** Enter the foreign trust’s aggregate undistributed net income (UNI). For example, assume that a trust was created in 1997 and has made no distributions prior to 2003. Assume the trust’s ordinary income was \$0 in 2002, \$60 in 2001, \$124 in 2000, \$87 in 1999, \$54 in 1998, and \$25 in 1997. Thus, for 2003, the trust’s UNI would be \$350. If the trust earned \$100 and distributed \$200 during 2003 (so that \$100 was distributed from accumulated earnings), the trust’s 2004 aggregate UNI would be \$250 (\$350 + \$100 - \$200).

**Line 46.** Enter the foreign trust’s weighted undistributed net income (weighted UNI). The trust’s weighted UNI is its accumulated income that has not been distributed, weighted by the years that it has accumulated income. To calculate weighted UNI, multiply the undistributed income from each of the trust’s years by the number of

years since that year, and then add each year’s result. Using the example from line 45, the trust’s weighted UNI in 2003 would be \$1,260, calculated as follows:

Year	No. of years since that year	UNI from each year	Weighted UNI
2002	1	\$ 0	\$ 0
2001	2	60	120
2000	3	124	372
1999	4	87	348
1998	5	54	270
1997	6	25	150
<b>TOTAL</b>		<b>\$350</b>	<b>\$1,260</b>

To calculate the trust’s weighted UNI for the following year (2004), the trust could update this calculation, or the weighted UNI shown on line 46 of the 2003 Form 3520 could simply be updated using the following steps:

1. Begin with the 2003 weighted UNI.
2. Add UNI at the beginning of 2003.
3. Add trust earnings in 2003.
4. Subtract trust distributions in 2003.
5. Subtract weighted trust accumulation distributions in 2003. (Weighted trust accumulation distributions are the trust accumulation distributions in 2003 multiplied by the applicable number of years from 2003.)

Using the examples above, the trust’s 2004 weighted UNI would be \$1,150, calculated as follows.

2003 weighted UNI	\$1,260
UNI at beginning of 2003	+ 350
Trust earnings in 2003	+ 100
Trust distributions in 2003	- 200
Weighted trust accumulation distributions in 2003 (\$100 X 3.6)	-360
<b>2004 weighted UNI</b>	<b>\$1,150</b>

**Line 47.** Calculate the trust’s applicable number of years by dividing line 46 by line 45. Using the examples in the instructions for lines 45 and 46, the trust’s applicable number of years would be 3.6 in 2003 (1,260/350) and 4.6 in 2004 (1,150/250).

**Note:** Include as many decimal places as there are digits in the UNI on line 45 (e.g., using the example in the instructions for line 45, include three decimal places).

**Schedule C—Calculation of Interest Charge**

Complete Schedule C if you entered an amount on line 37 or line 41.

**Line 49.** Include the amount from line 48 of this form on line 1, Form 4970. Then compute the tax on the total accumulation distribution using lines 1 through 28 of Form 4970. Enter on line 49 the tax from line 28 of **Form 4970, Tax on Accumulation Distribution of Trusts.**

**Note:** Use Form 4970 as a worksheet and attach it to Form 3520.

**Line 51.** Interest accumulates on the tax (line 49) for the period beginning on the date that is the applicable number of years (as rounded on line 50) prior to the applicable date and ending on the applicable date. For purposes of making this interest calculation, the applicable date is the date that is mid-year through the tax year for which reporting is made (e.g., in the case of a 2003 calendar year taxpayer, the applicable date would

be June 30, 2003). Alternatively, if you received only a single distribution during the tax year that is treated as an accumulation distribution, you may use the date of that distribution as the applicable date.

For portions of the interest accumulation period that are prior to 1996 (and after 1976), interest accumulates at a simple rate of 6% annually, without compounding. For portions of the interest accumulation period that are after 1995, interest is compounded daily at the rate imposed on underpayments of tax under section 6621(a)(2). This compounded interest for periods after 1995 is imposed not only on the tax, but also on the total simple interest attributable to pre-1996 periods.

If you are a 2003 calendar year taxpayer and you use June 30, 2003, as the applicable date for calculating interest, use the table below to determine the combined interest rate and enter it on line 51. If you are not a 2003 calendar year taxpayer or you choose to use the actual date of the distribution as the applicable date, calculate the combined interest rate using the above principles and enter it on line 51.

**Table of Combined Interest Rate Imposed on the Total Accumulation Distribution**

Look up the applicable number of years of the foreign trust that you entered on line 50. Read across to find the combined interest rate to enter on line 51. Use this table only if you are a 2003 calendar year taxpayer and are using June 30, 2003 as the applicable date.

Applicable number of years of trust (from line 50)	Combined interest rate (enter on line 51)
1.0	0.0525
1.5	0.0810
2.0	0.1182
2.5	0.1648
3.0	0.2161
3.5	0.2696
4.0	0.3194
4.5	0.3680
5.0	0.4249
5.5	0.4843
6.0	0.5496
6.5	0.6179
7.0	0.6891
7.5	0.7635
8.0	0.8164
8.5	0.8693
9.0	0.9222
9.5	0.9751
10.0	1.0280
10.5	1.0809
11.0	1.1338
11.5	1.1867
12.0	1.2396
12.5	1.2925
13.0	1.3454
13.5	1.3983
14.0	1.4512
14.5	1.5041
15.0	1.5570

15.5	1.6099
16.0	1.6628
16.5	1.7157
17.0	1.7686
17.5	1.8215
18.0	1.8744
18.5	1.9273
19.0	1.9802
19.5	2.0331
20.0	2.0861
20.5	2.1390
21.0	2.1919
21.5	2.2448
22.0	2.2977
22.5	2.3506
23.0	2.4035
23.5	2.4564
24.0	2.5093
24.5	2.5622
25.0	2.6151
25.5	2.6680
26.0	2.7209
All Years Greater than 26.0	2.7738

(Note: Interest charges began in 1977.)

**Line 53.** Report this amount as additional tax (ADT) on the appropriate line of your income tax return (e.g., for Form 1040 filers, include this amount as part of the total for line 60 of your 2003 Form 1040 and enter "ADT" to the left of the line 60 entry space).

**Part IV—U.S. Recipients of Gifts or Bequests Received During the Current Tax Year From Foreign Persons**

**Note:** Penalties may be imposed for failure to report gifts that should be reported. See item 3 of Penalties on page 2.

A gift to a U.S. person does not include any amount paid for qualified tuition or medical payments made on behalf of the U.S. person.

If a foreign trust makes a distribution to a U.S. beneficiary, the beneficiary must report the amount as a distribution in Part III, rather than as a gift in Part IV.

Contributions of property by foreign persons to domestic or foreign trusts that have U.S. beneficiaries are not reportable by those beneficiaries in Part IV unless they are treated as receiving the contribution in the year of the transfer (e.g., the beneficiary is an owner of that portion of the trust under section 678).

A domestic trust that is not treated as owned by another person is required to report the receipt of a contribution to the trust from a foreign person as a gift in Part IV.

A domestic trust that is treated as owned by a foreign person is not required to report the receipt of a contribution to the trust from a foreign person. However, a U.S. person should report the receipt of a distribution from such a trust as a gift from a foreign person in Part IV.

**Line 54.** To calculate the threshold amount (\$100,000), you must aggregate gifts from different foreign

nonresident aliens and foreign estates if you know (or have reason to know) that those persons are related to each other (see definition of related person on page 4) or one is acting as a nominee or intermediary for the other. For example, if you receive a gift of \$75,000 from nonresident alien individual A and a gift of \$40,000 from nonresident alien individual B, and you know that A and B are related, you must answer "Yes" and complete columns (a) through (c) for each gift.

If you answered "Yes" to the question on line 54 and none of the gifts or bequests received exceeds \$5,000, do not complete columns (a) through (c) of line 54. Instead, enter in column (b) of the first line: "No gifts or bequests exceed \$5,000."

**Line 55.** Answer "Yes" if you received aggregate amounts in excess of \$11,827 during the current tax year that you treated as gifts from foreign corporations or foreign partnerships (or any persons that you know (or have reason to know) are related to such foreign corporations or foreign partnerships).

For example, if you, a calendar-year taxpayer during 2003, received \$5,000 from foreign corporation X that you treated as a gift, and \$8,000 that you received from nonresident alien A that you treated as a gift, and you know that X is wholly owned by A, you must complete columns (a) through (g) for each gift.

**Note:** *Gifts from foreign corporations or foreign partnerships are subject to recharacterization by the IRS under section 672(f)(4).*

**Line 56.** If you answered "Yes" to the question on line 56 and the ultimate donor on whose behalf the reporting donor is acting is a foreign corporation or foreign partnership, attach an explanation including the ultimate foreign donor's name, address, identification number (if any), and status as a corporation or partnership.

If the ultimate donor is a foreign trust, treat the amount received as a distribution from a foreign trust and complete Part III.

**Privacy Act and Paperwork Reduction Act Notice.**

We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

In addition, the Privacy Act requires that when we ask you for information we must first tell you our legal right to ask for the information, why we are asking for it, and how it will be used. We must also tell you what could happen if we do not receive it and whether your response is voluntary, required to obtain a benefit, or mandatory under the law.

Our authority to ask for information is sections 6001, 6011, and 6012(a) and their regulations, which require you to file a return or statement with us for any tax for which you are liable. Your response is mandatory under these sections. Section 6109 requires that you provide your social security number or employer identification number on what you file. This is so we know who you are, and can process your return and other papers. You must fill in all parts of the tax form that apply to you.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103. However, section 6103 allows or requires the Internal Revenue Service to disclose or give the information shown on your tax return to others as described in the Code. For example, we may disclose your tax information to the Department of Justice to enforce the tax laws, both civil and criminal, and to cities, states, the District of Columbia, U.S. commonwealths or possessions, and certain foreign governments to carry out their tax laws. We may also disclose this information to Federal and state agencies to enforce Federal nontax criminal laws and to combat terrorism.

Please keep this notice with your records. It may help you if we ask you for other information. If you have any questions about the rules for filing and giving information, please call or visit any Internal Revenue Service office.

The time needed to complete and file this form and related schedules will vary depending on individual circumstances. The estimated average times are:

Recordkeeping .....	42 hr., 34 min.
Learning about the law or the form .....	4 hr., 38 min.
Preparing the form .....	6 hr., 28 min.
Sending the form to the IRS .....	16 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to the Tax Products Coordinating Committee, Western Area Distribution Center, Rancho Cordova, CA 95743-0001. **Do not** send the tax form to this office. Instead, see **When and Where To File** on page 2.

Country Codes				
Enter on lines 6a and 6b and line 21, columns (a) and (b), the codes from the list below.				
Country	Code			
Abu Dhabi	TC	Cote D'Ivoire (Ivory Coast)	IV	Jordan
Afghanistan	AF	Croatia	HR	Juan de Nova Island
Albania	AL	Cuba	CU	Kazakhstan
Algeria	AG	Curacao	NT	Kenya
American Samoa	AQ	Cyprus	CY	Kingman Reef
Andorra	AN	Czech Republic	EZ	Kiribati (Gilbert Islands)
Angola	AO	Denmark	DA	Korea, Democratic People's
Anguilla	AV	Djibouti	DJ	Republic of (North)
Antarctica	AY	Dominica	DO	Korea, Republic of (South)
Antigua and Barbuda	AC	Dominican Republic	DR	Kosovo
Argentina	AR	Dubai	TC	Kurile Islands
Armenia	AM	East Timor	TT	Kuwait
Aruba	AA	Ecuador	EC	Kyrgyzstan
Ashmore and Cartier Islands	AT	Egypt	EG	Laos
Australia	AS	Eleuthera Island	BF	Latvia
Austria	AU	El Salvador	ES	Lebanon
Azerbaijan	AJ	Equatorial Guinea	EK	Lesotho
Azores	PO	Eritrea	ER	Liberia
Bahamas, The	BF	Estonia	EN	Libya
Bahrain	BA	Ethiopia	ET	Liechtenstein
Baker Island	FQ	Europa Island	EU	Lithuania
Balearic Islands (Mallorca, etc.)	SP	Falkland Islands (Islas Malvinas)	FK	Luxembourg
Bangladesh	BG	Faroe Islands	FO	Macau
Barbados	BB	Fiji	FJ	Macedonia (former Yugoslavia)
Bassas da India	BS	Finland	FI	Republic of
Belarus	BO	France	FR	Madagascar (Malagasy Republic)
Belgium	BE	French Guiana	FG	Malawi
Belize	BH	French Polynesia (Tahiti)	FP	Malaysia
Benin (Dahomey)	BN	French Southern and Antarctic		Maldives
Bermuda	BD	Lands	FS	Mali
Bhutan	BT	Gabon	GB	Malta
Bolivia	BL	Gambia, The	GA	Marshall Islands
Bonaire	NT	Gaza Strip	GZ	Martinique
Bosnia-Herzegovina	BK	Georgia	GG	Mauritania
Botswana	BC	Germany	GM	Mauritius
Bouvet Island	BV	Ghana	GH	Mayotte
Brazil	BR	Gibraltar	GI	Mexico
British Indian Ocean Territory	IO	Glorioso Islands	GO	Micronesia, Federated States of
Brunei	BX	Great Britain (United Kingdom)	UK	Midway Islands
Bulgaria	BU	Greece	GR	Moldova
Burkina Faso (Upper Volta)	UV	Greenland	GL	Monaco
Burma	BM	Grenada (Southern Grenadines)	GJ	Mongolia
Burundi	BY	Guadeloupe	GP	Montenegro
Cambodia (Kampuchea)	CB	Guam	GQ	Montserrat
Cameroon	CM	Guatemala	GT	Morocco
Canada	CA	Guernsey	GK	Mozambique
Canary Islands	SP	Guinea	GV	Namibia
Cape Verde	CV	Guinea-Bissau	PU	Nauru
Cayman Islands	CJ	Guyana	GY	Navassa Island
Central African Republic	CT	Haiti	HA	Nepal
Chad	CD	Heard Island and McDonald Islands	HM	Netherlands
Chile	CI	Honduras	HO	Netherlands Antilles
China, People's Republic of (including Inner Mongolia, Tibet, and Manchuria)	CH	Hong Kong	HK	New Caledonia
Christmas Island (Indian Ocean)	KT	Howland Island	HQ	New Zealand
Clipperton Island	IP	Hungary	HU	Nicaragua
Cocos (Keeling) Islands	CK	Iceland	IC	Niger
Colombia	CO	India	IN	Nigeria
Comoros	CN	Indonesia (including Bali, Belitung, Flores, Java, Moluccas, Sumatra, Timor, etc.)	ID	Niue
Congo (Brazzaville)	CF			Norfolk Island
Congo, Democratic Republic of (Zaire)	CG			Northern Ireland
Cook Islands	CW			Northern Mariana Islands
Coral Sea Islands Territory	CR			Norway
Corsica	VP			Oman
Costa Rica	CS			Pakistan
				Palau
				Panama
				Papua New Guinea
				Paracel Islands
				Paraguay
				Peru
				Philippines



Pitcairn Island	PC	Somalia	SO	Ukraine	UP
Poland	PL	South Africa	SF	United Arab Emirates	TC
Portugal	PO	South Georgia and the South		United Kingdom ( <i>England, Wales,</i>	
Puerto Rico	RQ	Sandwich Islands	SX	<i>Scotland, No. Ireland</i> )	UK
Qatar ( <i>Katar</i> )	QA	Spain	SP	United States	US
Redonda	VI	Spratly Islands	PG	Uruguay	UY
Reunion	RE	Sri Lanka	CE	Uzbekistan	UZ
Romania	RO	Sudan	SU	Vanuatu	NH
Russia	RS	Suriname	NS	Vatican City	VT
Rwanda	RW	Svalbard ( <i>Spitsbergen</i> )	SV	Venezuela	VE
Ryukyu Islands	JA	Swaziland	WZ	Vietnam	VM
St. Helena ( <i>Ascension Island and</i>		Sweden	SW	Virgin Islands ( <i>British</i> )	VI
<i>Tristan de Cunha Island Group</i> )	SH	Switzerland	SZ	Virgin Islands ( <i>U.S.</i> )	VQ
St. Kitts ( <i>St. Christopher and Nevis</i> )	SC	Syria	SY	Wake Island	WQ
St. Lucia	ST	Taiwan	TW	Wallis and Futuna	WF
St. Pierre and Miquelon	SB	Tajikistan	TI	West Bank	WE
St. Vincent and the Grenadines		Tanzania	TZ	Western Sahara	WI
( <i>Northern Grenadines</i> )	VC	Thailand	TH	Western Samoa	WS
San Marino	SM	Togo	TO	Windward Islands	VC
Sao Tome and Principe	TP	Tokelau	TL	Yemen ( <i>Aden</i> )	YM
Sarawak	MY	Tonga	TN	Yugoslavia ( <i>Kosovo, Montenegro,</i>	
Saudi Arabia	SA	Tortola	VI	<i>Serbia</i> )	YO
Senegal	SG	Trinidad and Tobago	TD	Zaire ( <i>Democratic Republic of</i>	
Serbia	YO	Tromelin Island	TE	<i>Congo</i> )	CG
Seychelles	SE	Tunisia	TS	Zambia	ZA
Sierra Leone	SL	Turkey	TU	Zimbabwe	ZI
Singapore	SN	Turkmenistan	TX	Other Countries	OC
Slovak Republic ( <i>Slovakia</i> )	LO	Turks and Caicos Islands	TK	Unknown Country	UC
Slovenia	SI	Tuvalu	TV		
Solomon Islands	BP	Uganda	UG		

Exhibit 19.7 (continued)



<b>Part III Suspicious Activity Information</b>		<b>2</b>												
33 Date or date range of suspicious activity From ____/____/____ To ____/____/____ MM DD YYYY MM DD YYYY		34 Total dollar amount involved in known or suspicious activity \$ _____												
35 Summary characterization of suspicious activity: <table style="width: 100%; border: none;"> <tr> <td style="width: 33%; vertical-align: top;">                     a <input type="checkbox"/> Bank Secrecy Act/Structuring/ Money Laundering                      b <input type="checkbox"/> Bribery/Gratuity                      c <input type="checkbox"/> Check Fraud                      d <input type="checkbox"/> Check Kiting                      e <input type="checkbox"/> Commercial Loan Fraud                        s <input type="checkbox"/> Other _____                      (type of activity)                 </td> <td style="width: 33%; vertical-align: top;">                     f <input type="checkbox"/> Computer Intrusion                      g <input type="checkbox"/> Consumer Loan Fraud                      h <input type="checkbox"/> Counterfeit Check                      i <input type="checkbox"/> Counterfeit Credit/Debit Card                      j <input type="checkbox"/> Counterfeit Instrument (other)                      k <input type="checkbox"/> Credit Card Fraud                 </td> <td style="width: 33%; vertical-align: top;">                     l <input type="checkbox"/> Debit Card Fraud                      m <input type="checkbox"/> Defalcation/Embezzlement                      n <input type="checkbox"/> False Statement                      o <input type="checkbox"/> Misuse of Position or Self Dealing                      p <input type="checkbox"/> Mortgage Loan Fraud                      q <input type="checkbox"/> Mysterious Disappearance                      r <input type="checkbox"/> Wire Transfer Fraud                      t <input type="checkbox"/> Terrorist Financing                      u <input type="checkbox"/> Identity Theft                 </td> </tr> </table>			a <input type="checkbox"/> Bank Secrecy Act/Structuring/ Money Laundering b <input type="checkbox"/> Bribery/Gratuity c <input type="checkbox"/> Check Fraud d <input type="checkbox"/> Check Kiting e <input type="checkbox"/> Commercial Loan Fraud  s <input type="checkbox"/> Other _____ (type of activity)	f <input type="checkbox"/> Computer Intrusion g <input type="checkbox"/> Consumer Loan Fraud h <input type="checkbox"/> Counterfeit Check i <input type="checkbox"/> Counterfeit Credit/Debit Card j <input type="checkbox"/> Counterfeit Instrument (other) k <input type="checkbox"/> Credit Card Fraud	l <input type="checkbox"/> Debit Card Fraud m <input type="checkbox"/> Defalcation/Embezzlement n <input type="checkbox"/> False Statement o <input type="checkbox"/> Misuse of Position or Self Dealing p <input type="checkbox"/> Mortgage Loan Fraud q <input type="checkbox"/> Mysterious Disappearance r <input type="checkbox"/> Wire Transfer Fraud t <input type="checkbox"/> Terrorist Financing u <input type="checkbox"/> Identity Theft									
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36 Amount of loss prior to recovery (if applicable) \$ _____	37 Dollar amount of recovery (if applicable) \$ _____	38 Has the suspicious activity had a material impact on, or otherwise affected, the financial soundness of the institution? a <input type="checkbox"/> Yes    b <input type="checkbox"/> No												
39 Has the institution's bonding company been notified? a <input type="checkbox"/> Yes    b <input type="checkbox"/> No														
40 Has any law enforcement agency already been advised by telephone, written communication, or otherwise? <table style="width: 100%; border: none;"> <tr> <td style="width: 33%;">a <input type="checkbox"/> DEA</td> <td style="width: 33%;">d <input type="checkbox"/> Postal Inspection</td> <td style="width: 33%;">g <input type="checkbox"/> Other Federal</td> </tr> <tr> <td>b <input type="checkbox"/> FBI</td> <td>e <input type="checkbox"/> Secret Service</td> <td>h <input type="checkbox"/> State</td> </tr> <tr> <td>c <input type="checkbox"/> IRS</td> <td>f <input type="checkbox"/> U.S. Customs</td> <td>i <input type="checkbox"/> Local</td> </tr> <tr> <td colspan="3">j <input type="checkbox"/> Agency Name (for g, h or i) _____</td> </tr> </table>			a <input type="checkbox"/> DEA	d <input type="checkbox"/> Postal Inspection	g <input type="checkbox"/> Other Federal	b <input type="checkbox"/> FBI	e <input type="checkbox"/> Secret Service	h <input type="checkbox"/> State	c <input type="checkbox"/> IRS	f <input type="checkbox"/> U.S. Customs	i <input type="checkbox"/> Local	j <input type="checkbox"/> Agency Name (for g, h or i) _____		
a <input type="checkbox"/> DEA	d <input type="checkbox"/> Postal Inspection	g <input type="checkbox"/> Other Federal												
b <input type="checkbox"/> FBI	e <input type="checkbox"/> Secret Service	h <input type="checkbox"/> State												
c <input type="checkbox"/> IRS	f <input type="checkbox"/> U.S. Customs	i <input type="checkbox"/> Local												
j <input type="checkbox"/> Agency Name (for g, h or i) _____														
41 Name of person(s) contacted at Law Enforcement Agency		42 Phone Number (include area code) (    )												
43 Name of person(s) contacted at Law Enforcement Agency		44 Phone Number (include area code) (    )												
<b>Part IV Contact for Assistance</b>														
45 Last Name		46 First Name												
47 Middle														
48 Title/Occupation	49 Phone Number (include area code) (    )	50 Date Prepared ____/____/____ MM DD YYYY												
51 Agency (if not filed by financial institution)														

Exhibit 19.8 (continued)

Part V	Suspicious Activity Information Explanation/Description	3
<p><b>Explanation/description of known or suspected violation of law or suspicious activity.</b></p> <p>This section of the report is critical. The care with which it is written may make the difference in whether or not the described conduct and its possible criminal nature are clearly understood. Provide below a chronological and complete account of the possible violation of law, including what is unusual, irregular or suspicious about the transaction, using the following checklist as you prepare your account. If necessary, continue the narrative on a duplicate of this page.</p> <p>a Describe supporting documentation and retain for 5 years.</p> <p>b Explain who benefited, financially or otherwise, from the transaction, how much, and how.</p> <p>c Retain any confession, admission, or explanation of the transaction provided by the suspect and indicate to whom and when it was given.</p> <p>d Retain any confession, admission, or explanation of the transaction provided by any other person and indicate to whom and when it was given.</p> <p>e Retain any evidence of cover-up or evidence of an attempt to deceive federal or state examiners or others.</p>	<p>f Indicate where the possible violation took place (e.g., main office, branch, other).</p> <p>g Indicate whether the possible violation is an isolated incident or relates to other transactions.</p> <p>h Indicate whether there is any related litigation; if so, specify.</p> <p>i Recommend any further investigation that might assist law enforcement authorities.</p> <p>j Indicate whether any information has been excluded from this report; if so, why?</p> <p>k If you are correcting a previously filed report, describe the changes that are being made.</p> <p>For Bank Secrecy Act/Structuring/Money Laundering reports, include the following additional information:</p> <p>l Indicate whether currency and/or monetary instruments were involved. If so, provide the amount and/or description of the instrument (for example, bank draft, letter of credit, domestic or international money order, stocks, bonds, traveler's checks, wire transfers sent or received, cash, etc.).</p> <p>m Indicate any account number that may be involved or affected.</p>	
<p>Tips on SAR Form preparation and filing are available in the SAR Activity Review at <a href="http://www.fincen.gov/pub_reports.html">www.fincen.gov/pub_reports.html</a></p>		
<p><i>(This area is intentionally left blank for the user to provide additional information.)</i></p>		

**Paperwork Reduction Act Notice:** The purpose of this form is to provide an effective and consistent means for financial institutions to notify appropriate law enforcement agencies of known or suspected criminal conduct or suspicious activities that take place at or were perpetrated against financial institutions. This report is required by law, pursuant to authority contained in the following statutes. Board of Governors of the Federal Reserve System: 12 U.S.C. 324, 334, 611a, 1844(b) and (c), 3105(c) (2) and 3106(a). Federal Deposit Insurance Corporation: 12 U.S.C. 93a, 1818, 1881-84, 3401-22. Office of the Comptroller of the Currency: 12 U.S.C. 93a, 1818, 1881-84, 3401-22. Office of Thrift Supervision: 12 U.S.C. 1463 and 1464. National Credit Union Administration: 12 U.S.C. 1766(a), 1786(c). Financial Crimes Enforcement Network: 31 U.S.C. 5318(g). Information collected on this report is confidential (5 U.S.C. 552(b)(7) and 552a(k)(2), and 31 U.S.C. 5318(g)). The Federal financial institutions' regulatory agencies and the U.S. Departments of Justice and Treasury may use and share the information. Public reporting and recordkeeping burden for this information collection is estimated to average 30 minutes per response, and includes time to gather and maintain data in the required report, review the instructions, and complete the information collection. Send comments regarding this burden estimate, including suggestions for reducing the burden, to the Office of Management and Budget, Paperwork Reduction Project, Washington, DC 20503 and, depending on your primary Federal regulatory agency, to Secretary, Board of Governors of the Federal Reserve System, Washington, DC 20551; or Assistant Executive Secretary, Federal Deposit Insurance Corporation, Washington, DC 20429; or Legislative and Regulatory Analysis Division, Office of the Comptroller of the Currency, Washington, DC 20219; or Office of Thrift Supervision, Enforcement Office, Washington, DC 20552; or National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314; or Office of the Director, Financial Crimes Enforcement Network, Department of the Treasury, 2070 Chain Bridge Road, Vienna, VA 22182. The agencies may not conduct or sponsor, and an organization (or a person) is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

<b>Suspicious Activity Report Instructions</b>
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**Safe Harbor** Federal law (31 U.S.C. 5318(g)(3)) provides complete protection from civil liability for all reports of suspicious transactions made to appropriate authorities, including supporting documentation, regardless of whether such reports are filed pursuant to this report's instructions or are filed on a voluntary basis. Specifically, the law provides that a financial institution, and its directors, officers, employees and agents, that make a disclosure of any possible violation of law or regulation, including in connection with the preparation of suspicious activity reports, "shall not be liable to any person under any law or regulation of the United States, any constitution, law, or regulation of any State or political subdivision of any State, or under any contract or other legally enforceable agreement (including any arbitration agreement), for such disclosure or for any failure to provide notice of such disclosure to the person who is the subject of such disclosure or any other person identified in the disclosure".

**Notification Prohibited** Federal law (31 U.S.C. 5318(g)(2)) requires that a financial institution, and its directors, officers, employees and agents who, voluntarily or by means of a suspicious activity report, report suspected or known criminal violations or suspicious activities may not notify any person involved in the transaction that the transaction has been reported.

<p><b>In situations involving violations requiring immediate attention, such as when a reportable violation is ongoing, the financial institution shall immediately notify, by telephone, appropriate law enforcement and financial institution supervisory authorities in addition to filing a timely suspicious activity report.</b></p>
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**WHEN TO MAKE A REPORT:**

1. All financial institutions operating in the United States, including insured banks, savings associations, savings association service corporations, credit unions, bank holding companies, nonbank subsidiaries of bank holding companies, Edge and Agreement corporations, and U.S. branches and agencies of foreign banks, are required to make this report following the discovery of:
  - a. **Insider abuse involving any amount.** Whenever the financial institution detects any known or suspected Federal criminal violation, or pattern of criminal violations, committed or attempted against the financial institution or involving a transaction or transactions conducted through the financial institution, where the financial institution believes that it was either an actual or potential victim of a criminal violation, or series of criminal violations, or that the financial institution was used to facilitate a criminal transaction, and the financial institution has a substantial basis for identifying one of its directors, officers, employees, agents or other institution-affiliated parties as having committed or aided in the commission of a criminal act regardless of the amount involved in the violation.
  - b. **Violations aggregating \$5,000 or more where a suspect can be identified.** Whenever the financial institution detects any known or suspected Federal criminal violation, or pattern of criminal violations, committed or attempted against the financial institution or involving a transaction or transactions conducted through the financial institution and involving or aggregating \$5,000 or more in funds or other assets, where the financial institution believes that it was either an actual or potential victim of a criminal violation, or series of criminal violations, or that the financial institution was used to facilitate a criminal transaction, and the financial institution has a substantial basis for identifying a possible suspect or group of suspects. If it is determined prior to filing this report that the identified suspect or group of suspects has used an "alias," then information regarding the true identity of the suspect or group of suspects, as well as alias identifiers, such as drivers' licenses or social security numbers, addresses and telephone numbers, must be reported.
  - c. **Violations aggregating \$25,000 or more regardless of a potential suspect.** Whenever the financial institution detects any known or suspected Federal criminal violation, or pattern of criminal violations, committed or attempted against the financial institution or involving a transaction or transactions conducted through the financial institution and involving or aggregating \$25,000 or more in funds or other assets, where the financial institution believes that it was either an actual or potential victim of a criminal violation, or series of criminal violations, or that the financial institution was used to facilitate a criminal transaction, even though there is no substantial basis for identifying a possible suspect or group of suspects.
  - d. **Transactions aggregating \$5,000 or more that involve potential money laundering or violations of the Bank Secrecy Act.** Any transaction (which for purposes of this subsection means a deposit, withdrawal, transfer between accounts, exchange of currency, loan, extension of credit, purchase or sale of any stock, bond, certificate of deposit, or other monetary instrument or investment security, or any other payment, transfer, or delivery by, through, or to a financial institution, by whatever means effected) conducted or attempted by, at

or through the financial institution and involving or aggregating \$5,000 or more in funds or other assets, if the financial institution knows, suspects, or has reason to suspect that:

- i. The transaction involves funds derived from illegal activities or is intended or conducted in order to hide or disguise funds or assets derived from illegal activities (including, without limitation, the ownership, nature, source, location, or control of such funds or assets) as part of a plan to violate or evade any law or regulation or to avoid any transaction reporting requirement under Federal law;
- ii. The transaction is designed to evade any regulations promulgated under the Bank Secrecy Act; or
- iii. The transaction has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage, and the financial institution knows of no reasonable explanation for the transaction after examining the available facts, including the background and possible purpose of the transaction.

The Bank Secrecy Act requires all financial institutions to file currency transaction reports (CTRs) in accordance with the Department of the Treasury's implementing regulations (31 CFR Part 103). These regulations require a financial institution to file a CTR whenever a currency transaction exceeds \$10,000. If a currency transaction exceeds \$10,000 and is suspicious, the institution must file both a CTR (reporting the currency transaction) and a suspicious activity report (reporting the suspicious or criminal aspects of the transaction). If a currency transaction equals or is below \$10,000 and is suspicious, the institution should only file a suspicious activity report.

2. **Computer Intrusion.** For purposes of this report, "computer intrusion" is defined as gaining access to a computer system of a financial institution to:
  - a. Remove, steal, procure, or otherwise affect funds of the institution or the institution's customers;
  - b. Remove, steal, procure or otherwise affect critical information of the institution including customer account information; or
  - c. Damage, disable or otherwise affect critical systems of the institution.

For purposes of this reporting requirement, computer intrusion does not mean attempted intrusions of websites or other non-critical information systems of the institution that provide no access to institution or customer financial or other critical information.

3. A financial institution is required to file a suspicious activity report no later than 30 calendar days after the date of initial detection of facts that may constitute a basis for filing a suspicious activity report. If no suspect was identified on the date of detection of the incident requiring the filing, a financial institution may delay filing a suspicious activity report for an additional 30 calendar days to identify a suspect. In no case shall reporting be delayed more than 60 calendar days after the date of initial detection of a reportable transaction.
4. This suspicious activity report does not need to be filed for those robberies and burglaries that are reported to local authorities, or (except for savings associations and service corporations) for lost, missing, counterfeit, or stolen securities that are reported pursuant to the requirements of 17 CFR 240.17f-1.

#### HOW TO MAKE A REPORT:

1. Send each completed suspicious activity report to:

**Detroit Computing Center, P.O. Box 33980, Detroit, MI 48232-0980**

2. For items that do not apply or for which information is not available, leave blank.
3. If you are correcting a previously filed report, check the box at the top of the report (line 1). Complete the report in its entirety and include the corrected information in the applicable boxes. Then describe the changes that are being made in Part V (Description of Suspicious Activity), line k.
4. **Do not include any supporting documentation with the suspicious activity report.** Identify and retain a copy of the suspicious activity report and all original supporting documentation or business record equivalent for five (5) years from the date of the suspicious activity report. All supporting documentation must be made available to appropriate authorities upon request.
5. If more space is needed to report additional suspects, attach copies of page 1 to provide the additional information. If more space is needed to report additional branch addresses, include this information in the narrative, Part V.
6. Financial institutions are encouraged to provide copies of suspicious activity reports to state and local authorities, where appropriate.





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## 20.1 Introduction

Interviewing is an important part of a quality investigation and examination. It is important to have an initial dialogue with a person who has sufficient knowledge about the areas of interest. This person must be in a position to provide timely information that can be relied upon. The determination of whether a person is knowledgeable will depend on the examiner's judgment. It is as important as any technical ability to examine documents, prepare work papers, or conduct audits.

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## 20.2 Purpose

The purpose of interviewing is to obtain and develop information. It provides leads in developing a case. The examiner can meet and talk with and evaluate witnesses or victims. The examiner should record the interview in some form that will later help witnesses in remembering their statements at trials or hearings. Interviews also establish evidence. Cases are presented to a jury through the testimony of witnesses. Therefore, it is the examiner's duty to interview every witness connected with the case.

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## 20.3 Types of Witnesses

There are three types of witnesses: cooperative or friendly witness, neutral witness, and hostile or adverse witness.

1. **Cooperative witness.** The cooperative witness is more than willing to give information. This is particularly true if he or she is also the victim. However, a cooperative witness not only gives facts, but also mixes them with opinions. Sometimes, cooperative witnesses want something in exchange for whatever reason. They should be evaluated very closely. They might not be suitable witnesses on the witness stand because of biases and lack of objectivity.



2. **Neutral witness.** Neutral witnesses have no or little interest in the case. Even though they make the best witness, they do not always provide all the necessary evidence. This is particularly true in cases of custodians of records. Most have never seen the subject and sometimes have difficulty in locating all their records.
3. **Hostile witness.** The hostile witness is harder for the examiner to interview. A witness who lies or becomes uncooperative or evasive may indicate dishonest intent or have a close association with the subject under investigation. The interview should be conducted professionally and with a high degree of formality. The interview should start with identification of the witness and later the identification of the subject. A hostile witness can be softened up if he is not accused, even though the evidence is clear and convincing. The examiner should let the witness have an “out” or offer an excuse for his behavior. Rewards for cooperation or punishment for being uncooperative should be pointed out. Under no circumstances should the examiner make any promises or guarantees. The examiner should never reveal his knowledge or lack thereof to the witness. The more the witness talks, the better, because more information or evidence can be obtained.

## 20.4 Planning the Interview

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Proper planning of the interview is important. The examiner must have a general idea as to what the witness knows, what she can provide, and her relationship to the subject. Prior to any interview, the examiner should review all the information and data relating to the case. Such information can be divided into three general categories.

1. Information that can be documented, and need not be discussed
2. Information that may be documented, but needs to be discussed
3. Information that must be developed by testimony

The examiner should prepare a file that contains only data or information, arranged in the order it is to be discussed or covered in the interview. The examiner should determine the purpose or goal for questioning. An outline should be prepared, more or less in detail. The outline should contain only information that is relevant and material including hearsay. Important topics should be set off or underscored, and related topics listed in their proper sequence. The examiner should keep specific questions to a minimum since they tend to reduce the flexibility of the examiner. The examiner should cover as much information as possible. The time and place can be scheduled for cooperative witnesses. The best place to interview them is at their place of business or where they keep documents. In case of hostile witnesses, it is best to approach them unannounced. This prevents the witness from contacting the subject or an attorney, or from disappearing. The interview outline should cover at least:

1. Name, address, employment, and contact telephone numbers
2. Witness connection to the subject
3. Meetings and telephone conversations with subject
4. Documents furnished by the subject to the witness
5. Other potential witnesses

6. Financial dealings, including any losses
7. Information about the history and background of the subject
8. Any other material or relevant information or evidence

## 20.5 Conducting the Interview

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During the interview, you must keep an open mind that is receptive to all information, regardless of the nature, and be prepared to develop it. If you are not flexible, you may waste a great deal of time and ask unnecessary questions, resulting in a voluminous statement of little or no value. Although you may find it easier to adhere to a fixed pattern of interviewing, or to rely upon a series of questions or topics, rigid adherence to any notes or outline will seriously impair flexibility. The outline and data should serve only as guides and not as substitutes for original and spontaneous questioning. A carefully planned outline will provide enough leeway to allow the examiner to better cope with any situations that may occur and permit him or her to develop leads that may arise.

Establishing good communications with the witness in the initial interview is essential because it provides an opportunity to obtain information, which may not be readily available at a later date. A skilled examiner leads the interview so that he or she obtains as much information as possible. The examiner encourages the witness to discuss himself or herself, family, hobbies, financial history, and relations with others, including the subject of the investigation. After the initial contact, some witnesses may procrastinate or become less communicative. Therefore, plan for and conduct your initial interview so that you obtain as much information as possible. Let the witness talk; you be a good listener. The obvious fact about interviewing is that it involves communication between two or more people. It is a specialized professional type of conversation requiring all the facilities and tools of good speech and communication. Techniques should be developed that lead witnesses into answering desired questions. The examiner should gain a clear understanding of the witness's or subject's lifestyle and financial dealings. Statements made by the witness or subject may be used later as a test of their truthfulness and accuracy. Always be alert for any indications of fraud on the part of the witness or subject. Witnesses or subjects may have had unusually good or bad luck. Let them discuss their failures or successes. These are leads that are obtained in the interview and should alert you to follow up with questions to document these failures or successes. Nonresponse to specific questions should be enough to note the answer or lack of it. Follow through on every pertinent lead and incomplete answer. Continue asking questions until all information that can reasonably be expected has been obtained.

The following suggestions will help the examiner follow through and obtain answers that are complete and accurate:

1. Use short questions confined to one topic that can be clearly and easily understood.
2. Ask questions that require narrative answers; avoid "yes" and "no" answers whenever possible.
3. Question the witness about how he or she learned what is stated to be fact. The subject should also be required to give the factual basis for any conclusions stated.
4. Whenever possible, avoid questions that suggest part of an answer — leading questions.

5. Be alert so as to prevent the witness from aimlessly wandering. Where possible, require a direct response.
6. Prevent the witness from leading you far afield. Do not allow the witness to confuse the issue and leave basic questions unanswered.
7. Concentrate more on the answers than on the next questions.
8. To avoid an unrelated and incomplete chronology, clearly understand each answer and ensure that any lack of clarity is eliminated before continuing.
9. When all important points have been resolved, terminate the interview; if possible, leave the door open for further meetings.

The witness or subject should completely answer the following basic questions:

1. **Who.** Complete identification should be made of all persons referred to. This includes description, address, alias, “trading as,” “also known as,” citizenship, reputation, and associates.
2. **What.** Complete details as to what happened. Questions should relate to events, methods, and systems. A complete answer should be developed. Trace the event from its inception to its ultimate termination.
3. **Where.** Complete details regarding financial records and affairs, including their locations, witnesses, clients, customers, and the like.

## 20.6 Recording of Interview

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The principal purpose of interviews is to obtain all the facts helpful in resolving the case. Thus, it is necessary to prepare a permanent record of every interview to be preserved for future use. The methods used to record and document the interview are as follows:

### 20.6.1 Affidavit

An affidavit is a written or printed declaration or statement made voluntarily, and confirmed by the oath or affirmation of the party making it before an officer having authority to administer such oath. The procedures for taking an affidavit are:

1. **When to take an affidavit.** An affidavit should be taken when an affiant presents information, written or oral, relating to his or her knowledge about the matter under investigation that has a material effect.
2. **How to take an affidavit.** Ideally, two examiners or investigators should be present, although it is permissible for one representative to do so. One representative will swear in the affiant after the affidavit is filled out by asking: “Do you swear or affirm that the foregoing facts are true to the best of your knowledge?” The affiant must have his or her right hand raised at the time of reply to this statement.
3. **An affidavit should contain, at a minimum, the following:**
  - a. Name. This could contain current full legal name or any current or prior aliases.
  - b. Address. The most current address.
  - c. Occupation. The present occupation of the person giving the affidavit. If the information relates to a prior occupation, that should be given.

- d. Identified document. If the person giving the affidavit is presenting a document, it should be described as precisely as possible.
- e. When prepared. If a document is presented, it should be noted as to when it was prepared.
- f. Who prepared it. The preparer must be noted.
- g. Source prepared from. If the information contained in the document was taken from another source, state what the source was.

### 20.6.2 Memorandum of Interview

A memorandum of interview is an informal method of recording an interview. It is basically putting down on paper what the examiner learned from the interview. The memorandum of interview should be done as soon as possible after the interview since the examiner's knowledge is fresh in his mind. The examiner should have taken notes to help in writing his memorandum. The memorandum of interview should contain at least the following:

1. Date and time of interview
2. Place or location of interview
3. People present at the interview
4. Date the memorandum was prepared
5. Summary of the conversation that took place
6. As much information as possible about the interview and what the subject or witness said

The examiner should sign the memorandum of interview.

### 20.6.3 Question-and-Answer Statement

The question-and-answer statement is a formal method of interviewing a witness or subject. It sometimes requires the presence of a court reporter who will generally administer an oath and record the proceedings verbatim. If a court reporter is not used, then a tape recording is used and later transcribed. The witness is always administered an oath. The witness may be later required to read and swear or affirm to the transcribed proceedings. Even though this is a preferred method to use because it precludes a witness or subject from changing his testimony, it may not be admissible in court since cross-examination has not taken place. If the subject provides such a statement, then his legal rights should be explained to him before taking such a statement. If a tape recorder is used in lieu of a reporter or as a backup to the reporter, consent must be obtained on the record, from the witness or subject. The question-and-answer statement is similar to a deposition, except in a deposition cross-examination is done by the opposing counsel or party.

An experienced reporter will be able to transcribe notes made under adverse conditions. However, if recording conditions are improved, then the reporter will be able to transcribe notes much more rapidly and with less chance of error.

The following techniques will help the reporter to do a better job.

1. **Brief the reporter before the interview.** The examiner should provide the names of the people expected to be present. The reporter must identify each speaker. It will be helpful if the reporter knows the witness's line of business and has a general

idea of the line of questioning to be pursued. The reporter should read any correspondence or memoranda that you have that would be helpful, particularly where unusual names may be involved.

2. **Control the interview.** Remind those present to speak one at a time. The reporter cannot record two voices simultaneously. This is essential even if you are using a tape recorder. The machine will not encounter any difficulty in recording several voices at once, but when you play it back you will not be able to understand a word of it.
3. **Open the interview in a formal manner.** Open the interview by saying, "This is the testimony of (name of witness) taken in (complete address) at (time) on (date) in the matter of (suspected crime). Those present are (list all persons present at the interview)." This information is necessary for preparing your transcript, and by opening in this manner, you can be sure that these facts are accurately recorded. This formal opening also affords a built-in warm-up for both examiner and reporter. Additionally, it alerts all participants that anything they say after this time will be recorded.
4. **Avoid overlapping.** Overlapping is the practice of breaking in with another question before the witness has finished speaking. The transcript will have a better appearance if all parties have spoken in complete sentences. Also, it is necessary to listen carefully to the replies of your witness rather than thinking ahead to the next question.
5. **Guard against multiple questions.** The interviewer should keep questions short, concise, and to the point. The interviewer can do a lot to head off the witness who tends to ramble without giving a specific answer. Questions should not be asked that require more than one answer or are leading.
6. **Assist your reporter with a witness difficult to record.** The interviewer may have a witness with an extraordinary rapid rate of speech or with a heavy accent or other speech peculiarity that makes it very difficult for the reporter to follow. A break of only 1 or 2 seconds in the flow of difficult language makes a world of difference to the reporter. Some helpful things an interviewer can do in such situations are:
  - a. Speak more slowly than usual when asking your questions.
  - b. If you have a document you wish to show the witness, reach for it in a leisurely manner.
  - c. Glance at the reporter to see if he or she is ready before you ask your next question.
7. **Remember, there are no shortcuts to writing figures.** Speak slowly when giving a number with several digits. There are no shortcuts to writing figures, and they have no context. A rapidly spoken 13-digit number followed immediately by a flow of words will force the reporter to try to carry possibly 5 digits and 7 or 8 words in her head simultaneously. The possibility of error will be greatly reduced if you speak more slowly when numbers are involved.
8. **Identify documents.** If you have occasion to refer to documents, identify them specifically, such as "cash disbursement book, advertising expense column." If you say, "this book" and "that column," a reviewer examining the transcript will not be sure which documents or columns you have made reference to.
9. **Be aware of the required transcription time.** When the reporter prepares a transcript of an interview, he or she must set it up in question-and-answer form,

numbering each question and answer and identifying all speakers. This adds to typing time. The required transcription time for the reporter's examination is 1 hour for 5 minutes dictation at 160 words per minute. This would mean 6 hours are needed to transcribe a 30-minute interview. If the examiner knows the transcription time required, he will not expect to record a 6-hour interview on Monday and find a finished transcript on his desk by Wednesday morning. When you need a completed transcript by a certain date, take this factor into consideration when setting the date of the interview.

#### **20.6.4 Statement**

A statement is a written record by the witness or subject regarding his knowledge of an offense that possibly took place. The interviewer should be sure that the statement is dated and, in some instances, signed. A statement does not have to be sworn to. The witness should write down everything that he saw and heard before, during, and after the event. This helps the witness to later recall the events in detail, even things that were not put in the statement.

### **20.7 Interviews**

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The fraud examiner should be very aware of the importance of interviews, particularly of witnesses. Interviews are as just as important as the documentary evidence. Remember, especially in criminal cases, there must be both physical evidence and a witness. With no witness, the documentary evidence may not be admissible. Witnesses can not only furnish evidence in the case, but also furnish leads to other evidence and witnesses. The fraud examiner should follow up on these leads. When conducting interviews of witnesses or the subject, the fraud examiner should always take a professional attitude. The fraud examiner is only interested in getting the facts. Witnesses give not only facts, but also opinions. The fraud examiner has to take great care to differentiate facts from opinions. Keep in mind, you can "get more flies with honey than you can get with vinegar."

#### **20.7.1 Interview Techniques**

Over many decades, criminologists have developed various interview techniques. One technique is called kinesic interviewing, which encompasses the answers to questions as well as body movements (language), e.g., movements of the head, hands, arms, etc. Certain movements by the subject can indicate deception when she answers particular questions. This method has the disadvantage of the interviewer being present with the subject. The presence of an authority figure tends to make the subject less talkative.

Another method of interviewing is to have the subject or witness take a polygraph test. Similar to kinesic interviewing, the polygraph relies on body responses to answers. The polygraph machine measures various bodily changes that occur when a person lies. During the test, tubes are placed on the chest and abdomen to collect respiratory data. Metal connectors are placed on the finger to record sweat gland activity and blood pressure. The polygraph records significant changes in the subject's baseline physiological data. A lie will cause identifiable changes in one or more of the physical responses measured by the

polygraph. The polygraph examiner will begin by asking “yes” or “no” questions. The questions gradually become more intense and relevant to the particular act under investigation. The disadvantage of the polygraph is that it makes the subject feel that the interviewer is intrusive and he becomes less informative. Also, if the subject is nervous or jittery during the whole session, or the questions have no physiological response, the polygraph test has no meaning. Subjects of polygraphs may try to deceive it. One method is by taking sedatives before the test in hope of altering results. Sedatives lower blood pressure and enhance relaxation, which the polygraph measures. A subject may apply deodorant to his fingertip to help prevent perspiration. A subject may step on a tack inside his shoe to cause anxiety. Last, the subject might bite down on his tongue or check in hopes that the pain will increase anxiety levels to cause false readings on the machine.

### **20.7.2 Kinesic Interviewing**

As stated above, this technique observes body movements. Some body language signs can indicate deception or lying. These include:

1. Crossing legs
2. Hand over mouth
3. Shifting in chair
4. Crossing arms
5. Shaking head
6. Biting lips
7. Leaning forward
8. Steepled hands
9. Avoiding eye contact

### **20.7.3 Statement Analysis**

Another technique is to obtain an open-ended statement from the subject or witness. The statement is analyzed to determine deception or to gather more information about an event. The subject or witness may refuse to provide a written statement, which is the technique’s disadvantage. However, it has several advantages over other techniques. First, the interviewer does not need to be present. In fact, it is better for the interviewer not to be present, since a person does not feel threatened. Second, a questionnaire can be given to many people at one time. This saves time and effort if many witnesses have to be interviewed at one time. The following paragraphs briefly discuss the theory and procedures in the use of statement analysis.

#### **20.7.3.1 Characteristics**

The interviewer studies the statement for inconsistencies. This can be used for any language in which the interviewer is proficient. A truthful statement reflects reality. A deceptive statement distorts reality. The interviewer analyzes what the person has said and not what he knows. The theory behind statement analysis is that everyone wants to give information to everyone. The more the interviewer expects the subject to talk, the higher the probability that the subject will talk. As long as the subject is not saying, “I don’t want to talk,” he is willing to talk. The interviewer must be careful in asking questions because it might be from the questions that the subject would learn how to be deceptive. Leading questions

are a good example of this type of questioning. The only forbidden question is a question that the person refuses to answer. The interviewer should not enter into any unnecessary argument with the subject. Also, the interviewer should not make any accusations. There is no coincidence in life, and nothing happens in a vacuum. Deception is any assertion believed or known by the speaker to be untrue with the intent to mislead. The more specific, direct, closed, and difficult the question is, the more difficult it is to lie. Statement analysis involves not only the content of a statement, but also the structure of the statement. The structure is very important. Structure involves the use of pronouns, connections, changes in language, use of verbs, time frames, unnecessary or unimportant information, and tenses.

**20.7.3.1.1 Pronouns.** The use of pronouns is important. They are objective. Pronouns are usually mentioned after a social introduction. Pronouns are used because they shorten the sentence and make life easier. If pronouns come before the introduction, then it is rude and impolite and might indicate a bad relationship. If the introduction is repeated more than once, then this indicates a bad relationship or something is wrong. The use of *we* without an introduction is indicative of a bad relationship.

The following are pronouns: I, you, he, she, it, we, you, they, my, your, his, her, our, their, me, us, him, them, myself, himself, herself, and ourselves. Pronouns give responsibility and possession by the speaker. When the subject says *we*, that means someone was with him. Pronouns are not subjected to the person's personal language. Changes of pronouns in the same sentence indicate that there might be deception in the statement. The lack of *I* in a statement or paragraph indicates tension. Too many uses of *I* are not good because this indicates tension and possible deception. *We* is important, especially in white-collar crime when dealing with corporations and partnerships, because no one functions alone. *We* inside a statement would give an indication of whether the subject was relaxed. Was the subject tense at the time of the crime? Changes in language reflect a change in reality.

*With* indicates distance in reality whether in time or place. The interviewer should inquire about the relationship or events about a place when *with* is used. A bad relationship is indicated when a person changes *my* to *the*. This is important in disputes about possession in arson and child abuse cases.

**20.7.3.1.2 Connections.** A connection is a phrase that joins two different links in a statement. An unnecessary connection usually replaces information, which the subject intentionally took out of the statement. Verbs that refer to leaving a place are very significant. The more times *left* or equivalent expressions are found in a statement, the more sensitive the statement becomes. Many deceptive statements start or end with *left*. An answer that ends with a question mark indicates resistance, and it means that the question before the answer is a sensitive one for the person. Connections that should be identified are:

- Later on
- Sometime later
- Shortly thereafter
- Afterwards
- After that
- The next thing I remember/knew



Verbs that indicate missing information are:

- Started
- Began
- Continued
- Proceeded
- Completed
- Finished
- Ended

If the subject did not mention the reason for the break in activity, then the interviewer should ask why. Failure to give a reason may indicate deception. Connections are expressions that come to indicate missing time. This is indicative of what the subject did not want the interviewer to know.

**20.7.3.1.3 Out-of-Sequence Information.** Out-of-sequence information might be the most important information. It is only out of sequence for the reader or listener; it is in sequence by the subject. If a person gives information that has no connection to the question, then there is a connection. Language is not independent, but was produced by the mind. There are no coincidences in life. The basic questions for the reader or listener to ask are:

- Why did the person say it?
- Why did the person say it this way?
- Why did the person say it this way at this specific location in the statement?
- Why did the person use this specific amount of subjective time?

Out-of-sequence information is an indication that surgery was performed on the statement. The subject took out some information, but left in the statement the effects of missing information. Out-of-sequence information is a specific case of an unnecessary link. Even though it is an unnecessary link, not every unnecessary link is out of sequence. A truthful story will have unnecessary links. An unnecessary link can be made by a change in pronouns or vocabulary. If the sequence of events justifies the change, then the person is truthful; if not, then the person is deceptive. An unnecessary link is any link that can be taken out of the statement and the story will still flow smoothly.

**20.7.3.1.4 Objective vs. Subjective Times.** Objective times are 2/50 not subject to the subject's personal language. Objective times are the only connections from subjective reality to objective reality. Objective times enable the interviewer to check the subjective time used to describe different links. Many criminals put the time of the crime inside the story. If any objective time is mentioned in the statement, the interviewer should see if it corresponds to the time of the crime. If it does, then there is a suspicion that the person committed the crime. Missing time is time in which a person could have committed the crime. Finding missing information results in solving most cases.

**20.7.3.1.5 Unimportant Information.** Unimportant activities might be doubly important. If a person is truthful, then the interviewer must obtain the answers to the basic questions:

Why did the subject say it?

Why did the subject say it this way?

Why did the subject say it where he did in the statement?

Why did the subject take the time to say it?

**20.7.3.1.6 Verbs Regarding Communication.** When a person mentions *talking* in an open-ended statement, it means that this was an important conversation. If *we* is missing in the conversation, then the conversation resulted in an argument or disagreement. The following verbs regard communication: talking, speaking, chatting, discussing, conversation. A *discussion* indicates disagreement or argument between the parties. *Talking* or *chatting* indicates a closer relationship between the parties.

### 20.7.3.2 Inquiry

The goal of an interviewer is to obtain information. The first questionnaire is an open-ended statement about an event. This is to get as much information about an event as possible. This is called getting a pure version, since the interviewer should have total belief in the statement. The second interview is conducted to get specific information. The direct inquiry wants specific answers to questions, and the goals are to get answers to points left out in the original version, get a complete picture, and determine if the person is deceptive. A direct inquiry is closed, direct, and difficult. Thus, the subject's answers become less reliable and might teach the subject to lie. The interviewer should not tell the subject that he is deceptive if the interviewer is not sure of it. If the subject is truthful, then the accusations can produce deceptive behavior, and that will confuse the interviewer.

### 20.7.3.3 Questionnaire

The interviewer must provide a questionnaire to the subject or witness. The first questionnaire should be designed to get as much information as possible and obtain a commitment by the person. The second questionnaire should be designed to address the various issues on the original statement. The first questionnaire, known as the pure version, should comprise a small booklet, which the subject will complete. It is recommended that it have the following pages, as a minimum:

1. **Instructions.** The first page should instruct the subject as to how to complete the questionnaire. The subject should be advised that he should write his answers as detailed as possible. The subject should use a pen while writing — no typing is allowed — and his handwriting should be clear to enable reading. No corrections are allowed.
2. **Page 2.** This page should ask the subject to explain what happened during the day the event took place or to give a detailed explanation of what the person did during the day the event took place. For example: “Describe in detail your workday on (mm/dd/yy), covering the time you came to work until the time you ended the day.”
3. **Page 3.** This page commits the subject to his previous statement. For example: “Would you like to change any of the information you have provided?”

## 20.8 Summary

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As one can see, interviewing subjects and witnesses is very important. It basically comprises about half the case in terms of importance. Criminal cases require witnesses to introduce evidence, physical or documentary. The most serious obstacle to obtaining information is the interviewer: the interviewer either does not ask the proper questions or influences the person to lie. In many cases, the interviewer does *not* listen to what a person says. Yet, it is easier for a person to talk to a stranger than to someone he knows. Also, it is not easy to lie. People lie by omission (in their statements), and not by commission.



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## 21.1 Introduction

Fraud examiners find that their best and probably most useful evidence is various bank records. Banks maintain various kinds of records, some of which the customer does not have available. Many customers like using one or more banks on a regular basis. They want to establish a working relationship, which in turn gives a sense of security. Money launderers particularly want good relationships with bankers, so that they might look the other way when money launderers do business. Bank records are perhaps the single most important financial source. They can provide leads to sources of funds, expenditures, and personal affairs, and they may be used as evidence to prove criminal and civil violations.

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## 21.2 Bank Services

Many banks offer all or many of the following services:

1. **Checking accounts.** These are sometimes called demand accounts since the customer can make deposits and withdrawals at will. This is probably the most common service at banks. Many banks offer checking accounts for individuals, which have service charges of a flat fee or low fees. In some areas, checking accounts are provided free to certain types of customers, e.g., elderly, minors, etc. Corporate or business checking accounts have service charges based on account activity and/or the maintaining of minimum daily balances.
2. **Savings accounts.** Savings accounts are often referred to as time deposits. Banks usually offer three types of savings accounts:
  - a. **Passbook.** This is a savings account in which the customer has ready access to her funds, and the bank pays interest on the average balance. However, the customer cannot write checks, but must physically withdraw the funds at the bank. Banks require a minimum balance, usually between \$200 and \$1,000.
  - b. **Money market.** This is a savings account in which the customer has ready access to his funds. The customer can write checks against the account with some limitations. The bank pays interest on these accounts at market rates.

- c. **Certificates of deposits.** The customer buys a certificate of deposit, basically a savings account, where the customer cannot withdraw the funds over a period that ranges from 3 months to 2 or 3 years. Interest is paid periodically and usually deposited into the checking account. Early withdrawals can result in penalties. Many banks will renew the certificates of deposit if the customer does not tell the bank not to do so.
  - d. **Individual Retirement Accounts.** Financial institutions, banks, and savings and loans offer customers a savings plan from which the individual cannot withdraw without penalties until he or she reaches age 59½ years old or older. These accounts usually offer a higher return because the customer cannot withdraw money until retirement. In effect, these are tax-deductible savings accounts for the customer. The bank has to file the appropriate forms with the Internal Revenue Service showing that the customer has an Individual Retirement Account.
3. **Loans.** Banks make their money from making loans to customers. Many customers not only have checking and savings accounts, but also borrow funds from the bank for purchasing items. Banks will lend money provided that they have collateral, e.g., automobiles, boats, real estate, etc., for individuals. They make loans to businesses using inventory or equipment of the business for collateral. Banks do not make loans to customers unless they have good credit standing in the community.
  4. **Safe deposit box.** Banks offer customers safe deposit boxes for rent. These safe deposit boxes are locked boxes in a highly secured vault. The boxes come in various sizes. Customers can use these vaults to store important papers, documents, and other valuables with safety and security.
  5. **Credit cards.** Banks offer customers access to bank credit cards, Mastercard or Visa. They like their customers to use credit cards because they charge a very high interest rate on these cards. Customers can use these cards to purchase goods and services, as well as get cash advances.
  6. **Trust services.** Many banks offer trust services. These services vary widely, depending on what the customer wants done on his behalf. The bank, as trustee, could manage anything from simple trusts, e.g., collecting investment income, to complex trusts involving the management of huge amounts of assets, investments, and income for the grantor. The grantor will probably have the bank, as trustee, provide funds to beneficiaries as set forth in the trust agreement.
  7. **Exchange instruments.** Banks offer customers various vehicles of transferring funds. They are:
    - a. **Cashier's checks.** Cashier's checks are bank checks. The customer purchases these checks for a small fee. Cashier's checks are usually issued for large amounts, \$500 and up.
    - b. **Money orders.** Money orders are similar to cashier's checks, but they are issued for small amounts, usually \$500 or less.
    - c. **Certified checks.** Certified checks are customer's checks on which "certified" is written or stamped across the front of the check. This certification is a guarantee that the bank will pay the check. Certified checks are liabilities of the bank and, when paid, are kept by the bank. However, the customer can obtain the checks by surrendering debit memoranda that the bank has charged the customer's account.

- d. **Wire transfers.** Banks can transfer funds from an internal account to an account at another bank by electronic means. The customer's account is charged for the amount of the transfer plus a fee. These electronic transfers can be done in minutes, and they can be done to any bank in the U.S. or any foreign country that has the ability to accept wire transfers.

### 21.2.1 Checking Account Operation

A customer goes to his neighborhood bank to open a checking account. She will go through the following procedures in opening and operating the checking account:

1. **Opening.** The customer will be asked to provide the following:
  - a. **Signature card.** The signature card needs to have the full name, address, city, state, zip code, telephone number, Social Security number, and signature of each person who is going to sign on the account. It is called a signature card since each person who can sign checks must sign the card.
  - b. **Initial deposit.** The customer is required to make a minimum deposit. This is usually between \$200 and \$500.
  - c. **Corporation resolution.** If a corporation is opening a checking account, then it must submit a corporate resolution, which shows the corporate officers who can sign on the account. In many instances, the corporation might require that two corporate officers jointly sign checks.
2. **Checks.** The customer writes checks to various people for various purposes. The check requires the customer to complete the following items:
  - a. **Date.** The customer must put the date that the check is written. However, some customers may postdate or backdate a check.
  - b. **Payee.** The customer writes the name of the payee who is to receive the funds. Sometimes, customers write checks to cash in order to obtain cash.
  - c. **Numeric amount.** The customer puts the dollar amount of the check. This is written in figures.
  - d. **Written amount.** The customer writes out in longhand the amount of the check. This amount should agree with the numeric amount written above. If they are different, banks will usually pay the written amount.
  - e. **Signature.** The customer must sign the check. The signature must correspond to that provided by the customer on the signature card when she initially opened the account.
3. **Deposits.** The customer must deposit funds, currency, and checks into the checking account to cover the withdrawals. The customer must complete a deposit slip, which requires the following:
  - a. **Date.** The customer must record the date the deposit is made.
  - b. **Cash.** The customer must record the amount of currency or coins being deposited.
  - c. **Items.** The customer must list every check or draft that is being deposited. This column shows from whom the check was received. Some people list the bank routing number of the customer's check while others list the name of the sender. Corporations sometimes list the customer's internal account number.

- d. **Amount.** The customer fills in the amount of the check that was received and is being deposited.
  - e. **Total deposit.** The customer must sum up all cash and checks and place the total at the bottom of the deposit slip. Some banks even want a total count of checks being deposited.
4. **Statement.** The bank sends the customer a statement each month summarizing each deposit and withdrawal. It also gives the beginning and ending balances according to the bank. The customer is now obligated to reconcile his statement to his check register. For corporations, the bank statement must be reconciled to the cash receipts and disbursement journals, and general ledger for that bank account. Most banks include with the statement the deposit slips and each cancelled check received by the bank. Many banks show not only the date and amount of each check, but also the check number. In a few cases, the bank shows the payee on the check and whether the deposit was a check or cash.

### 21.2.2 Savings Account Operation

Savings accounts operate almost identically to checking accounts. Money market accounts function the same as checking accounts, except that they receive interest on account balances. The interest can be computed on either the average balance (most are) or the monthly ending balance. Passbook and certificate of deposit accounts are issued periodic statements that show principal and interest earned for the period and year to date. In the case of certificates of deposit, when the term has expired, the customer must notify the bank as to whether the certificate of deposit is to be renewed, transferred, or refunded to the customer. If the customer fails to notify the bank of his intentions, then the bank will automatically renew the certificate of deposit, which could be at either a higher or lower rate than the original rate.

### 21.2.3 Loans

Banks offer a variety of loans: installment loans, home equity loans, business loans, signature loans, and mortgages. Banks earn their income from the interest on loans. A performing loan is one that the customer pays on time. A nonperforming loan is one that the customer is constantly late in making repayments on or does not pay at all. Banks usually commence foreclosure proceedings when the nonperforming loan reaches 90 days past due.

1. **Installment loans.** Installment loans are the most common loans provided by banks; they are also the most profitable. The interest on installment loans is computed based on the add-on interest method. Interest is rebated on the rule of 78s. The add-on interest method is basically taking the interest rate and multiplying it by the number of years the loan is to run. The rule of 78s is basically adding the total months the loan is to run. It is rebated by the factor of adding the months remaining over the total months of the loan. This is multiplied to the total interest charged on the loan. For example:

Term: 12 months

Interest charged: \$1,000

Payoff period: 6 months have elapsed

The payoff would be computed as follows:

$$(1 + 2 + 3 + 4 + 5 + 6) = 21/78 \times \$1,000 = \$269.23$$

*Note:* Seventy-eight is the sum of the numbers 1 through 12 — thus the rule of 78.

2. **Mortgages.** Banks can provide prospective home owners with mortgages to purchase a home. Banks usually require a better credit rating and better income than other financial institutions. Banks can provide mortgages that range from 15 to 30 years. Interest rates range from prime to several points above prime. Also, banks offer both fixed-rate and variable-rate mortgages. Simple interest is charged on the monthly balances. Banks charge the customer points for providing the loan. These points are for the costs the bank incurs in preparing and providing the mortgage. Many banks require the mortgagee to deposit funds into an escrow account for the payment of taxes and insurance. The bank uses these escrow accounts to pay property taxes and home owner's insurance directly.
3. **Home equity loans.** Home equity loans are loans based on the home owner's equity in the house. It is defined by banks as the difference between the mortgage on the property and the fair market value. Banks will loan funds up to the amount of fair market value less 10% and the mortgage. Home equity loans usually have an interest rate of two or more points above the prime rate. Most home equity loans have variable interest rates. Some banks offer revolving loans in which the loan balances can go up and down as the home owner borrows and repays the loan.
4. **Business loans.** Banks make loans to businesses. Inventory, accounts receivable, or equipment usually secures these loans. The loans are normally for a short term, which ranges from 1 month to a few years. Many business loans are rolled over. Interest rates range from prime and up, depending on the business's credit rating.
5. **Signature loans.** Banks will provide loans to individuals with no collateral. However, these loans are rare and are only provided to customers with a high credit rating. Interest rates range from prime and up to the maximum rate allowed by law.

#### 21.2.4 Safe Deposit Box

Banks offers customers the renting of a box in a secured vault. Banks do not have access to this box except by court order or nonpayment of rental charges. Customers use these boxes to store important papers and documents. They are also used to store jewelry, cash, and negotiable instruments. These boxes come in various sizes. Banks maintain a log of every person who accesses the safe deposit box. It generally shows the name of the person, his signature, and the date and time he entered. Heavy access to a safe deposit box can indicate a cash hoard, especially when deposits are made on the same date.

#### 21.2.5 Credit Cards

Credit cards are becoming more widespread in their use. Some businesses will only accept credit cards, while others will accept only cash or credit cards, but no checks of any kind. Many businesses have electronic terminals that can verify whether the credit card is good. If it is bad, the business is supposed to confiscate the card. Most banks have a credit card division, which issues and maintains customers' accounts. When a customer uses his credit



card, the business establishment deposits the slips into the bank or sends them to the card issuer for payment.

### **21.2.5.1 Credit Card Companies**

There are currently five major credit card companies. Each company has a number, which prefixes the card number and indicates the kind of credit card:

1. Carte Blanche 3
2. American Express 3
3. Visa 4
4. Mastercard 5
5. Discover 6

Carte Blanche, American Express, and Discover require the merchant to send charge slips directly to them. The merchant is sent a draft less the fees. Visa and Mastercard require the merchant to deposit the charge slips into their bank account. The bank charges the merchant's bank account for the fees. Banks become members of Visa and/or Mastercard companies who operate the system. They mail out statements to customers and collect the customers' payments. In turn, the credit card companies forward earnings (interest) to the banks. For banks, credit cards are very profitable because of the high interest charged. Even with frauds committed by either customers or merchants, banks earn more from credit card interest than they receive on other types of loans. The bank credit card companies publish a book that shows each bank's identification number (BIN). This book is not made available to the general public.

### **21.2.5.2 Card Numbers**

Visa and Mastercard use a 16-digit number grouped in fours. The first eight digits (on the left) indicate the type of credit card, the bank identification number, and the routing number. The last eight digits represent the customer's account number.

### **21.2.6 Trust Services**

Many banks offer trust services. These services vary depending on what the customer wants. Banks have the ability to service many kinds of trusts, ranging from simple to complex. Fees are based on the amount of services required to be performed. Trustees are required to file state and federal income tax returns. Some trusts are taxed on their earnings, while others pass the income down to the grantor. The grantor is deemed to be the owner of the trust's assets. The most common trusts are:

1. **Decedent's trust.** The trustee takes control of the decedent's assets, liabilities, income, and expenses. The trustee distributes the net income and assets to the beneficiaries after the estate is probated and taxes, expenses, and liabilities have been paid. A simple version of this is called the insurance trust. The grantor assigns his life insurance policies to the trustee. The trustee distributes the insurance proceeds after death of the grantor to the beneficiaries based on the grantor's wishes.
2. **Intervivos trust.** The grantor transfers all or part of his assets to the trustee. The grantor is still living. The trustee administers the trust assets in accordance with

the grantor's wishes. The grantor can make the trust an irrevocable trust in which the grantor loses control of his assets. A revocable trust is one in which the grantor can terminate the trustee at any time and regain control of his assets.

Many criminal elements use trusts to hide their assets in order to keep them out of the reach of the government and law enforcement agencies.

### 21.2.7 Exchange Instruments

Banks offer the following exchange services for customers. Exchange instruments are basically the withdrawals of funds from bank accounts for various bank instruments.

1. Cashier's checks
2. Money orders
3. Certified checks
4. Wire transfers

### 21.2.8 Magnetic Ink Character Recognition

Magnetic ink character recognition (MICR) was developed by the American Bankers Association (ABA) as a machine language and as a standard in check design to which all banks must conform. Numeric information is printed in magnetic ink on the bottom of bank checks and other documents. This coding is electronically scanned by computers, which convert the magnetic ink notations into electronic impulses intelligible to a computer. MICR information is printed in groupings called fields. On bank checks, the first field on the left is the Federal Reserve check routing code and the next is the ABA transit number. These numbers also appear in the upper right corner of the check. The middle group of numbers shows the drawer's assigned account number at the bank. The MICR information in these two fields is imprinted on the blank checks furnished to the customer. The right field contains a control number used for processing and the amount of the check. The dollar amount of the check should be compared with the encoded amount to be sure the subject did not alter the returned check. Many banks are adding an additional field for the check number. Some place this field after the account number, while others place it before the account number.

### 21.2.9 Bank Reconciliation

The bank sends a statement along with the cancelled checks, deposit slips, and credit and debit memoranda each month. It is up to the customer to reconcile his bank account with his check register. Many banks provide the customer a bank reconciliation schedule on the back of the statement. A typical example of bank reconciliation is as follows:

Balance per bank's statement \$ \_\_\_\_\_  
 Add: Deposits in transit \_\_\_\_\_  
 Less: Outstanding checks \_\_\_\_\_  
 Balance per reconciliation \_\_\_\_\_

The customer will usually have to make adjustments to her check register to show current bank charges, interest earned, and any deposits or checks that cleared the bank but were not recorded. Otherwise, the customer will not be able to reconcile to the above example.

## **21.3 Government Securities**

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Banks also sell and redeem government securities. They sell U.S. bonds, bills, and notes. Bills are of very short duration, usually 60 to 360 days. Notes are short term, usually 3 to 10 years. Bonds are long term, usually 20 or more years.

### **21.3.1 Currency Transaction Reports**

Banks are required to file Currency Transaction Reports with the U.S. Treasury Department whenever a customer makes a cash withdrawal or deposit, purchases cashier's checks, or makes payments on loans of \$10,000 or more. These reports are discussed in more detail in Chapter 19.

### **21.3.2 Correspondence**

Banks maintain a file of all letters to and from customers. Most bank customer correspondence relates to granting and servicing loans. However, banks maintain files of customer complaints. The bank's internal auditors review these letters to determine adherence to bank policies and internal controls.

### **21.3.3 Letters of Credit**

Banks issue an official form of correspondence called letters of credit, which ask other banks to extend credit to the holder of the letter. These letters are generally issued to bank customers who have an established banking relationship. The customer must have an approved credit line or funds on account that can cover the letter of credit amount.

### **21.3.4 Foreign Currency Exchange**

Many banks offer customers the ability to exchange foreign currency for U.S. dollars or vice versa. Banks charge a small fee for this service. Banks must keep records of any foreign currency exchanges. Currency Transaction Reports will have to be filed if the exchange involves \$10,000 or more U.S. dollars.

### **21.3.5 Bank Records**

Of all the sources of financial information, banks rank at the top of the list. They can provide a wealth of financial data. These data can help the fraud examiner to determine the customer's lifestyle and financial patterns and show the degree of sophistication. When requesting and obtaining copies of bank records, examiners and investigators should use the following checklist:

1. Records of checking accounts:
  - a. Monthly statements

- b. Deposit tickets
- c. Cancelled checks
- d. Signature cards
- e. Debit and credit memoranda
- f. Deposit items
2. Records of savings accounts, certificates of deposit, or any other income producing positive balance instruments:
  - a. Ledger cards and monthly account statements
  - b. Deposit slips
  - c. Deposited items
  - d. Transfer slips
  - e. Withdrawal slips
  - f. Cancelled checks used for withdrawals
  - g. Signature cards
  - h. Items of withdrawals
  - i. Debit and credit memoranda
  - j. Interest statements (Form 1099, etc.)
3. Records of loan accounts:
  - a. Ledger cards
  - b. Repayment schedule
  - c. Cancelled loan checks
  - d. Signature card
  - e. Application, including supporting documents and escrow statements
  - f. Financial statements
  - g. Credit bureau reports
4. Records of credit card accounts:
  - a. Monthly statements
  - b. Sales drafts
  - c. Payment schedules
  - d. Interest schedules
  - e. Applications
  - f. Financial statements
  - g. Credit bureau reports
5. Safe deposit box records:
  - a. Application
  - b. Entry record
  - c. Signature card
6. Agreements, statements, account ledger sheets, and checks disbursed from or for any trust account established by or for the benefit of the person(s) specified
7. Wire transfer records
8. Cashier's checks or registers
9. Letters of credit
10. Cash transit letters
11. Money order records
12. Currency Transaction Reports, including records and source documents indicating transfer of funds prepared in compliance with currency and the Foreign Transaction Reporting Act (31 U.S. Code (USC) 1051)

13. Individual Retirement Accounts
  - a. Signature card
  - b. Ledger card and account statements
  - c. Cancelled checks
  - d. Deposit slips
14. Correspondence

## 21.4 Security Brokers

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The second most important source of financial information comes from securities dealers. Securities fall into two basic markets: trading of stocks and bonds, and commodities. Both markets operate under similar structures. The Securities and Exchange Commission regulates the securities industry. The broker is an agent who handles the public's orders to buy and sell securities, usually for a commission. A broker may be a corporation, partnership, or individual and is often a member of an exchange. A registered representative (also known as a securities salesperson or account executive) personally places customers' orders and maintains their accounts. While commonly referred to as a broker, a registered representative is usually an employee of a brokerage firm rather than a member.

### 21.4.1 Security Markets

The security markets are classified into two categories: organized exchanges and over-the-counter market.

1. **Organized securities exchanges.** Securities exchanges or stock exchanges neither buy nor sell securities themselves. An exchange functions as a central marketplace and provides facilities for executing orders. Member brokers representing buyers and sellers carry out the transactions. The two major exchanges are the New York Stock Exchange (NYSE) and the American Stock Exchange (AMEX), both located in New York City. While there are various regional exchanges, the NYSE and AMEX together handle more than 90% of the trading done through organized exchanges. If a security is to be traded on an exchange, the issue must be approved for listing by that exchange. Securities traded on the NYSE and AMEX may also be listed and traded on the regional exchanges, but no security is listed on both the NYSE and AMEX. The National Association of Securities Dealers Automated Quotations (NASDAQ) operates as a stock exchange.
2. **Over-the-counter market.** The over-the-counter securities market handles most of the security transactions that take place in the U.S. The over-the-counter market does not handle the purchase or sale of securities that actually occur on securities exchanges, but it handles everything else in the way of securities transactions. Thus, securities not listed on a securities exchange are unlisted, that is, traded over the counter. The over-the-counter market is not located in any one central place. It consists of thousands of security houses located in hundreds of different cities and towns all over the U.S. These security houses are called brokers or dealers and are engaged in buying and selling securities, usually for their own account and risk. There are many more types of securities that are traded in the over-the-counter market than what is traded on the national or regional exchanges. These include:

- a. Bank stocks
- b. Insurance company stocks
- c. U.S. government securities
- d. Municipal bonds
- e. Open-ended investment company shares (mutual funds)
- f. Most corporate bonds
- g. Stocks of a large number of industrial and utility corporations, including nearly all new issues
- h. Securities of many foreign corporations

#### **21.4.1.1 Ownership of Securities**

There are two principal ways securities are held: in the name of the account holder and in street name. In the first instance, the customer's name is reflected on the security and the account. When securities are held in street name, they are registered in the name of the broker. This occurs when securities have been bought on margin or when a cash customer wishes the security to be held by the broker, rather than in his or her own name.

#### **21.4.2 Stock Classes**

When a corporation is formed, capital stock representing the ownership of the corporation is authorized in the corporate charter. There are two principal classes of stock: common and preferred. If only one class of stock is authorized, it is common stock. The number of shares authorized can be changed by formal approval of the stockholders. Shares issued and subsequently reacquired by the corporation through purchase or donation are referred to as treasury stock. The number of shares outstanding will always equal the number of shares issued, less the number of shares of treasury stock, unless stock has been repurchased and cancelled. Each stockholder is part owner of the corporation, since each share of stock represents a fractional interest in the corporation. The stockholder is entitled to a stock certificate showing ownership of a specific number of shares of stock in the corporation. If a stockholder desires to buy more stock, it is not necessary to obtain the permission of the corporation. The stockholder acquires it by purchase in the open market or privately. Conversely, if a stockholder desires to sell shares, he or she cannot demand the corporation to buy the stock. Instead, a stockholder is free to seek a buyer for the stock either in the market or by private sale. After the sale terms have been agreed upon, the mechanics of transfer are simple. The seller signs his or her name on the back of the stock certificate and delivers it to the buyer or the buyer's broker. A record of all outstanding certificates is kept by the corporation or by its duly appointed transfer agent, often a bank. The transfer agent has a record of the names and addresses of the stockholders and the number of shares owned by each. After determining that the old certificate is in proper form for transfer, the transfer agent issues a new certificate to a new owner. Most companies have a registrar. The duty of the registrar is to double-check the actions of the transfer agent to prevent improper issue of stock or fraudulent transfer.

#### **21.4.3 Stock Rights**

A common stockholder may usually subscribe (at a stated discount price) to new issues of common stock in proportion to his or her holdings. This privilege, known as a stock right, is usually offered to stockholders for a limited time. During this period, the stock-

holders may exercise the right to purchase additional shares under the terms of the offer or may choose to sell the rights. If the stockholder allows the time limit to run out without acting, the rights become worthless.

#### **21.4.4 Stock Warrants**

A stock warrant is a certificate that gives the holder the privilege of purchasing common stock at a stated price within a specified time limit or perpetually. Warrants are often issued with bonds or preferred stock as an added inducement to investors. The stockholder may exercise the right to purchase additional shares or choose to sell the warrants.

#### **21.4.5 Stock Splits**

When the price of the common stock of a corporation reaches a high market value, the corporation may choose to bring the price down to a more favorable trading range. To do this, the corporation splits its shares; that is, it increases the number of shares outstanding without issuing additional stock. If, for example, a stockholder owned 100 shares that had a market value of \$200 per share, a 4-to-1 stock split would increase the stockholder's shares to 400 and decrease the market value to \$50 per share. Although the stockholder now owns a greater number of shares, the value of the stock and proportionate interest remain unchanged.

#### **21.4.6 Dividends**

A corporation may pay a dividend in cash, stock, or property. When cash dividends are paid, the company, or its dividend-disbursing agent (usually a bank), sends checks to all the stockholders whose names appear on the books of the company on a so-called record date. A dividend is a prorated distribution among stockholders, and when cash dividends are paid, they are in terms of so much per share. Some companies, in order to conserve cash, pay dividends in their own stock. A stock dividend has an effect similar to that of a stock split in that the stockholder's proportionate share of the ownership remains unchanged. A stock dividend is usually stated as a percentage of the outstanding shares (up to a maximum of 25%, above which it is called a stock split). When a corporation pays a property dividend, it is usually in the form of stock in another corporation that has been acquired for investment or some other purpose.

#### **21.4.7 Bonds**

When a corporation or government unit wishes to borrow money for some period, usually for more than 5 years, it will sell a bond issue. Each bond, generally of \$1,000 denomination, is a certificate of debt of the issuer and serves as evidence of a loan to the corporation or governmental unit. The bondholder is a creditor of the issuer. A bond pays a stated rate of interest and matures on a stated date when the fixed sum of money must be repaid to the bondholder. Railroad, public utility, and industrial bonds are called corporate bonds. The obligations of states, counties, cities, towns, school districts, and authorities are known as municipal bonds. U.S. Treasury certificates, notes, and bonds are classified as government securities. Bonds are issued in two principal forms: coupon bonds and registered bonds.

1. **Coupon bonds.** Coupon bonds have interest coupons attached to each bond by the corporation that issues it. Because the corporation keeps no record of the owners of the bonds, they are called bearer bonds. On the due dates for the interest, the owner clips the coupons and presents them to the authorized bank for payment. The principal, when due, is payable to the holder or bearer of the bonds.
2. **Registered bonds.** Registered bonds have the name of the owner written on the front of the bond. The company, or its authorized agent (usually a bank), has a record of the name and address of the owner. When interest is due, it is paid to the bondholder by check.

#### 21.4.8 Types of Transactions

There are two types of transactions: long and short.

1. **Long transactions.** In a long transaction, an account holder purchases a security with the expectation that the market price of that security will appreciate or advance. Long simply means ownership of a security.
2. **Short transactions.** In a short transaction, an account holder sells a security that he or she does not own with the expectation that the market price of that security will decline. Short signifies a liability position in a security.

#### 21.4.9 Records

The broker can furnish all documents relating to securities account activity. The principal documents available from a broker are:

1. **Customer account cards.** This is a broker's record of the customer's account.
2. **Application for account.** This form contains basic information about the customer. Its primary purpose is to identify the customer so the customer can be contacted when needed.
3. **Signature cards and margin account agreements.** The customer must fill out a signature card, much like that of a signature card with a bank or other financial institution. In addition, the customer must sign a margin agreement if the customer opens up a margin account.
4. **Securities receipts.** The broker keeps copies of securities receipts for securities received from the customer.
5. **Cash receipts.** The broker keeps copies of receipts for funds received from the customer.
6. **Confirmation slips.** The broker keeps copies of confirmation receipts. Confirmation slips are used to confirm the customer's purchases and sales of securities.
7. **Securities delivered receipts.** The broker keeps copies of receipts of securities that are delivered to the customer.
8. **Cancelled checks.** The broker keeps cancelled checks of payments made to the customer.
9. **Monthly account statements.** The broker issues monthly statements. These statements show all transactions for the month. Unlike bank statements, brokerage statements show the customer's holdings and their market values at the end of the



month. This serves as a barometer for the customer as to how his or her holdings are faring in the marketplace.

10. **IRS reporting forms.** The broker is required to keep copies of all forms that report earnings and sales of securities to the Internal Revenue Service.

#### 21.4.10 Types of Accounts

There are two types of accounts that a customer can have with a broker:

1. **Cash.** This type of account requires the customer to pay securities in full at time of purchase.
2. **Margin.** This type of account allows securities to be purchased on credit. Margin is the percentage of the purchase price of a security that the customer must pay. The Federal Reserve Board establishes the margin requirement. To open a margin account, there must be a minimum deposit by the customer. Stock purchased on margin must be registered in street name while in the account. If the customer's margin falls below the minimum, then the broker can liquidate the account without permission of the customer if the customer fails to bring the margin up to proper requirements.

#### 21.4.11 Security Account Statements

The customer's security account statement (issued monthly) contains all transactions from the last statement date. These statements are the basic documents used to reconstruct a customer's security position. The following rules are applicable when analyzing security account statements:

1. **Buying.** The buy column will show the following entries:
  - a. Bought or received. This shows whether the customer bought or received the security that was previously purchased.
  - b. Description. This is the name of the security.
  - c. Price or symbol. This gives the purchase price per share.
  - d. Debit. This is the amount of the purchase price paid by the customer, including the broker's commission.
2. **Selling.** The sold column will show the following entries:
  - a. Sold or delivered. This column shows whether the customer sold or delivered a security to the broker.
  - b. Description. This identifies the security that is sold or delivered to the broker.
  - c. Price or symbol. This shows the unit sales price per share.
  - d. Credit. This shows the proceeds from the sales credited to the customer's account.

When a customer purchases stock, he or she has the option of taking delivery of the certificates from the broker or leaving them in the broker's custody. The customer usually indicates this when he or she opens up a brokerage account.

If a customer takes delivery of the certificates, the number of shares would be noted in the sold or delivered column, and the date column would show the date of delivery. In addition, there would be no entry in the price or symbol column.

If there are no entries indicating delivery of securities, the broker is in fact holding them and the customer is in what is commonly referred to as a long position. The broker will list at the bottom of the customer's statement a summary of the customer's long position, that is, a listing of the number of shares of each stock being held for the customer and their market values.

#### **21.4.12 Transfer Agent**

The transfer agent keeps a record of the name and address of each stockholder and the number of shares owned, and checks that certificates presented for transfer are properly cancelled and that new certificates are issued in the name of the transferee. In many small firms, the transfer agent is usually an attorney, a bank, or the corporation itself. In most large firms, the transfer agent is a bank. The transfer agent maintains the following information:

1. Stockholder identification
2. Stockholder position
3. Stock certificate numbers
4. Number of shares represented by certificates
5. Date certificates were issued or surrendered
6. Evidence of returned certificates
7. Names of transferees and transferors

The principal documents available from the transfer agent are:

1. Stockholder ledger card
2. Stock certificates

The names and addresses of transfer agents may be found from Moody's or Standard and Poor's for publicly held companies, or may be obtained from the main offices of the corporations.

#### **21.4.13 Dividend-Disbursing Agent**

Most large corporations distribute their dividends through agents known as dividend-disbursing agents. The dividend-disbursing agent is generally a bank and can furnish the following information:

1. Stockholder identification
2. Stockholder position
3. Amount of dividends
4. Form of dividend
5. Dates paid
6. Evidence of payments

The principal documents available from the dividend-disbursing agent are:





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## 22.1 Introduction

The fraud examiner has two important administrative duties to perform. The first is to obtain and maintain proper files. These files must be maintained so that evidence, statements, interviews, and financial information are readily and easily accessible. Second, the fraud examiner must prepare reports that are factual, clear, and relevant. This chapter is directed to help the fraud examiner set up and maintain his case files and prepare proper reports.

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## 22.2 Purpose

There are various reasons why reports and files are important. The primary ones are:

1. They give the attorney all the evidence that was obtained, so it can be evaluated as to its admissibility and success in court, whether civil or criminal.
2. They help evaluate the fraud examiner's work product regarding thoroughness, reliability, objectivity, relevancy, etc.
3. They force the fraud examiner to review his evidence and witness interviews or statements. If material or relevant facts have been omitted or not obtained, then the fraud examiner can go seek them out. Remember, fraud examiners will most often have to interview witnesses more than once to obtain all the facts.
4. They (should) give the attorney or reviewer all the material and relevant facts. They omit immaterial information, regardless of whether it was obtained.
5. They help the fraud examiner to ensure that all the evidence and witness statements have been obtained and are available. In quoting witnesses in the report, the fraud examiner should guard against misquoting or taking facts out of context.
6. They are the work product of the fraud examiner and tell the reviewer what the fraud examiner has done and what the fraud examiner feels to be material and relevant. The report must be true and correct. The reviewer or attorney may uncover additional evidence and witnesses that may alter the fraud examiner's report or render it invalid.

## 22.3 Report Characteristics

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The fraud examiner's report should consist of the following characteristics:

1. **Accuracy.** The report should contain all material and relevant evidence and witness statements. Any computational schedules should be correct. Any misquotes or mathematical errors can render the report useless. Times, dates, figures, and supporting information should be reaffirmed with witnesses or subjects.
2. **Clarity.** The report should use clear and simple language. It should not use slang or technical terminology. Those reading the report usually are not familiar with slang or technical language. If these must be used, then the fraud examiner should explain their meaning before continuing use. Witnesses may use such language in statements and interviews. The fraud examiner's report should definitely explain their meaning so the reader can understand.
3. **Prejudice.** The report should only give the facts. The report should not give the fraud examiner's biases or partialities. All facts should be shown regardless of which side they favor. The U.S. Supreme Court in *Brady v. Maryland*, 373 U.S. 83 (1963), better known as Brady, held that the government's failure to disclose evidence favorable to a defendant who specifically requested it violated the defendant's due process rights because the evidence was material to guilt or punishment. In addition, a defendant is also entitled to disclosure of information that might be used to impeach the government's or plaintiff's witnesses. Such information includes, but is not limited to, payments to witnesses, immunity, promises, witness biases, rewards offered or collected, etc.
4. **Relevance.** The fraud examiner should ensure that all relevant information is in the report. If in doubt as to the relevance of information, then include it. Any information that has either a direct or indirect bearing on the case should be reflected in the report. Immaterial or irrelevant information only confuses the reader and can lead to questions of the examiner's capabilities and methodologies.
5. **Promptness.** The fraud examiner should take notes during interviews of witnesses or possible subjects. These notes should be reduced to memoranda of interview or statements as soon as possible. The longer the examiner waits, the less the examiner will remember. The interim or final report should be prepared as soon as possible following the investigation. Delaying will result in the report missing material or relevant information. It is recommended that the fraud examiner *not* work on more than three cases at any one time, unless there are some extenuating circumstances.
6. **Opinions or conclusions.** The fraud examiner should never express an opinion of any kind on the guilt or innocence of the subject. The fraud examiner should never express any opinions or conclusions about witness testimonies or statements. Witness or subject statements will clearly be conflicting. Confidential informants should never be identified in either statements or the body of the report. The report should only identify confidential informants by codes or numbers. Some law enforcement agencies require conclusions in their reports. Actually, the conclusions are in reality recommendations. Law enforcement agencies want recommendations as to all possible courses of action that are available. Conclusions or opinions as to the guilt or innocence of the subject are not what they want.

## 22.4 Discovery

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The courts have held that investigators' notes can be used as evidence in court and must be made available to the defense. Therefore, the fraud examiner should never destroy or dispose of his interview notes, whether on a witness or subject. The fraud examiner does not have the right to privileged communications. However, there are two exceptions to the general rule:

1. The fraud examiner is conducting the investigation under the retainer of an attorney. In this case, the fraud examiner is working for the attorney and comes under the rules of the attorney–client privilege communications.
2. The fraud examiner is retained or hired by a law enforcement agency. This is considered privileged communications by the courts, especially in grand jury cases. Grand jury information cannot be disclosed unless authorized by the court.

## 22.5 Report Format

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There is no formal or set format for the fraud examiner's report. However, the fraud examiner should identify and cover the following items:

1. **Date.** The date of the report should be when the report is finally finished.
2. **Retainer.** The report should be addressed to the person and entity that has retained the fraud examiner. If the fraud examiner is an employee of an entity, then the report should be addressed to the employer.
3. **Subject.** The report should identify the subject of the investigation and the subject's full name, address, date of birth, and, in some instances, Social Security number.
4. **Case description.** The first paragraph should identify the type of case, such as embezzlement, kickbacks, theft, etc. It should never state that the subject committed an offense, but allege that the subject committed an offense.
5. **Investigator.** The report should identify all the investigators involved in the investigation and their respective roles.
6. **Type.** This section should identify the type of case under examination and investigation. There are basically three choices: criminal, civil, and administrative. A criminal investigation involves the potential conviction and imprisonment of the offender. A civil examination encompasses potential monetary damages. An administrative case involves the possibility of disciplinary action on the job, such as dismissal or demotion.
7. **History.** This section should give a brief history about the subject. It should include the following items:
  - a. **Identifiers.** The full names of the subject and immediate family members should be given. Dates of births, Social Security numbers, places of births, driver's license numbers, alien numbers if foreigners, etc., should also be included.
  - b. **Health.** The health conditions of the subject and his immediate family should be disclosed. This can have an effect on whether a criminal prosecution will be pursued.

- c. **Employment or business history.** The employment history of the subject should be fully identified. This should describe the skills and knowledge acquired from past and present employment. The employment history of the spouse may also be included if it has a bearing on the case. If the subject has operated businesses in the past or present, then they should also be identified.
  - d. **Education.** The educational history of the subject should also be disclosed, including whether the subject has a college degree. More sophisticated crimes are committed by well-educated people.
  - e. **Residence.** The subject's residence should be disclosed — not only the primary residence, but also any and all secondary residences, i.e., vacation homes, relatives' and friends' residences frequented by the subject, etc.
  - f. **Associates.** Friends, close business associates, and relatives should be identified in the report, along with their specific relationships.
  - g. **Travel.** The subject's travel experiences should be disclosed. This should include not only the past few years, but should go back two or more decades.
8. **Evidence.** This section should summarize the evidence that has been obtained to show that a crime has been committed and who committed the crime. It should identify both physical and oral (testimony) evidence. In a large case, this should be a brief summary, since many witness statements and physical evidence will be obtained that can explain it. The evidence should be categorized and indexed in a logical order. The index should contain a brief description and identify the witnesses and physical evidence. This can encompass large volumes of documents and witness statements or depositions. In small cases, the evidence, both oral and physical, can be summarized and referenced as attachments.
  9. **Intent.** This section should identify both the oral and physical evidence that shows the state of mind of the subject. Most cases require the prosecution or plaintiff to show intent to commit fraud on part of the subject. Intent is a state of mind. The state of mind to defraud someone is based on the actions and statements of the subject. These conditions and statements should be identified and referenced to the physical evidence, statements, or depositions.
  10. **Defenses.** This section should identify any defenses made by either the defendant or any other witness on behalf of the defendant. In addition, any evidence that contradicts the defenses should also be identified and referenced. This will help the prosecutor or plaintiff attorney to be prepared for these defenses.
  11. **Referrals.** This section should identify any referrals made to law enforcement agencies, state attorneys, or outside counsel. A copy of the referral report should be attached. If the fraud examiner is working for law enforcement, then this section is not required, since the report will be processed according to local procedures.
  12. **Financial data.** This section should disclose the total investigative costs, including fees charged, investigative expenses, administrative expenses, and other direct costs that are charged to the client. An itemized statement should be attached to the report. In addition to the investigative costs, the amount of the client's loss should be identified. A schedule should be attached to the report showing the details of the loss or illegal gains.
  13. **Recommendation.** This section should express all recommendations and actions that are available. The fraud examiner should not express any opinion as to the guilt or innocence of the subject.

## 22.6 Sources/Informants

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Identities of confidential informants should never be disclosed in the report. They should only be identified by codes (numbers or letters). Files on each confidential source or informant should be maintained and should contain the following:

1. **Identifiers.** There should be a profile or personal data sheet that contains information about the source or confidential informant. Such information should include, but is not limited to, full name, aliases, address, date and place of birth, driver's license number, Social Security number, INS alien number if applicable, and names and addresses of relatives, friends, and associates.
2. **Evaluation.** The fraud examiner should make notes of the confidential source or informant as to their reliability. This evaluation of reliability should be objective. These notes should reflect the information provided by the informant, and the information should be corroborated or verified. This fact should be noted in the file. One method is to write a memorandum of interview of the informant. When the information given by the confidential informant has been verified or corroborated, then another memorandum should be prepared showing what information was corroborated and what was not corroborated. A comparison of these data will show in an objective manner how reliable is the confidential informant. The more information the informant gives that is corroborated, the more reliable the informant becomes. The converse also holds true.
3. **Financial data.** Any financial dealings with the confidential informant should be documented. The fraud examiner or investigator should obtain a receipt from the informant for any funds paid to or on behalf of the informant. Failure to get receipts can put the examiner or investigator in an awkward position in court. Also, the Internal Revenue Service requires receipts for any deduction taken on a tax return. Failure to have a receipt will cause the disallowance of a deduction, which will result in a higher tax liability.

Confidential informant and source files should be kept in a highly secured place. The investigator or examiner should never pledge total secrecy. This can cause problems at a later date. The examiner or investigator can be jailed for failure to disclose a confidential informant when ordered by a court to disclose. Remember, the fraud examiner or investigator must keep his word for any promises that are made. Otherwise, the fraud examiner will lose his or her credibility on the street. Therefore, the fraud examiner can prevent this situation by only making a limited commitment.

## 22.7 Report Writing Mistakes

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There are mistakes in report writing besides the normal misspelling and grammar errors. Reports should always be reviewed for any misspelling and grammar errors. Other mistakes include:



1. **Opinions.** The fraud examiner should never express an opinion about the guilt or innocence of the subject. This opens up the door for the defense attorney to show bias on the part of the fraud examiner.
2. **Data.** Information presented in the report should be accurate. Even mistakes in small details can leave doubts about the accuracy of the report as a whole. A wrong date of birth of a subject can lead to the case being thrown out. This is especially true if it is constantly used.
3. **Quotes.** The examiner should not misquote a witness or subject. Misquotes can lead to doubts about the examiner's reliability. The fraud examiner should always have the witness or subject repeat statements that are important. In reports, the fraud examiner should cross-check any quotes made by a witness or subject.

## 22.8 Case Disposition

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When a case has been completed, its final disposition should be noted on the report. It is recommended that a disposition report be prepared and attached to the final report. The disposition report should provide:

1. **Fines.** The amount of fines imposed by the court should be shown.
2. **Prison sentence.** The prison sentence imposed by the court should be disclosed.
3. **Probation.** The probation term imposed by the court should be shown.
4. **Forfeitures and seizures.** All assets that were seized and forfeited to law enforcement agencies should be delineated. Each asset should be identified that was seized by law enforcement, along with its cost or market value. Also, if these assets were sold by law enforcement, then the sale proceeds should be noted. This may be impossible to find out in some cases, e.g., autos, boats, furniture, etc., when all seized assets are pooled and auctioned off.
5. **Dropped.** If the case was dropped, then this should be noted. An explanation should be given as to why the case was dropped. There are many reasons why a case is dropped: the lack of funds to pursue prosecution or a lawsuit, the lack of collectibility, insufficient evidence, the subject is deceased, it would generate a negative public image, etc.
6. **Judgments.** In civil cases, the amount of judgments awarded by the court should be noted. A copy of the judgment should be included in the case file.
7. **Restitution.** If the court ordered any restitution, the case file should note this. Also, a copy of the restitution order should be attached to the report.

## 22.9 Disclosure

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A log should be maintained on all people who have or have had access to the case files. This log should identify the person, date, reason for access, and who authorized the access. Also, the fraud examiner should issue a memorandum that identifies only those people that should have regular access to the case files. These people are generally the case examiner(s), clerical staff, client attorney, and any other person who has a need to know on a regular basis. Staff members should be instructed on disclosure of case files and

information. Cases should never be discussed outside the office. Case files should never be taken outside the office. Only copies of files should be taken for witness interviews. These instructions should also be included in the memorandum. Improper disclosure can result in the case being dropped, or the examiner and client being sued. In cases involving undercover work or similar actions, this can put the examiner at risk of not being able to perform the job as planned. In criminal cases, it can put the examiner's life at risk.

## 22.10 Witness List

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The fraud examiner or investigator should keep a witness list. This witness list should identify (1) the name of the witness, title or capacity, address, and both home and business telephone numbers, and, in summary, (2) the physical evidence that the witness can provide. Remember, witness files should be kept. The witness files should contain statements, depositions, and physical evidence. Some tangible evidence because of size or other characteristics may have to be kept in a separate property room. The witness file should have a note that describes in detail where the evidence is located and its description.

Using the scenario problem in Chapter 7, the witness list in Figure 22.1 is presented as an example. Besides identifying the witnesses, it also identifies the specific exhibits that the witnesses will introduce into court. Each witness and exhibit is assigned a number. *W* before the number identifies the number as a witness and not an exhibit. Exhibit numbers must be associated with the witness number and name.

The above witness list is condensed; however, a list should include the witnesses' names, addresses, home and business telephone numbers, and business or agency names. This witness list mostly covers the evidence introduced in Section 7.2 of the scenario problem. If witnesses can be obtained from offshore countries, then they and the evidence should be listed. In the case of offshore public records, they can be obtained by consular officers of the U.S. Department of State. The consular officer has the authority to introduce these documents into court (see the rules of evidence in Chapter 4). The bank records from Barclays Bank of London were not introduced into evidence because a witness from that bank institution must be used to authenticate them. The case detective who executed the search warrant could be used to introduce these records into court, but he could not testify regarding the authenticity.

The examiner should keep the witness list on a computer database. This can help the examiner counsel or prosecutor plan and schedule witnesses for trial. Costs can be reasonably estimated for paying witness expenses, i.e., witness fees, parking, travel, lodging if required, etc.

## 22.11 Case Files

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Case files are very important. They contain all of the evidence and witness statements or depositions. The two principal methods of keeping case files are:

1. **Originals.** Original or primary evidence and statements should be kept according to witness. A witness statement or deposition should be kept together with the physical evidence the witness provided. For trial purposes, this makes it easier for

Witness Number	Witness	Exhibit Number	Exhibit Description
W-1	Case detective	1	Property receipt for money seized
		2	Property receipt and lab report cocaine
		3	Barclays bank statements
		4	Gold bullion property receipt
		5	Copy of search warrant with court signatures
W-2	Public records administrator	1	100 Alpha St. deed
		2	100 Bravo St. deed
W-3	Life insurance company records custodian	1	Insurance policy
		2	Payment receipts
W-4	Furniture company records custodian	1	Purchase invoice
W-5	Cabinet company records custodian	1	Purchase invoice
W-6	Art dealer records custodian	1	Purchase invoice
W-7	Fixture company records custodian	1	Purchase Invoice
W-8	Pool and tennis contractor	1	Builders contract
		2	Payment schedule
W-9	Appliance dealer records custodian	1	Purchase invoice
W-10	Electronic store records custodian	1	Purchase invoice
W-11	Security system dealer records custodian	1	Purchase contract
		2	Payment schedule
W-12	IRS representative	1	1040 return 19X0
		2	1040 return 19X1
		3	1040 return 19X3
		4	1120 return 19X1
		5	1120 return 19X2
		6	1120 return 19X3
		7	1120S return 19X1
		8	1120S return 19X2
		9	1120S return 19X3
		10	1065 return 19X1
		11	1065 return 19X2
		12	1065 return 19X3
W-13	I. M. Balance, CPA	1	Financial statements for 19X2 store
		2	Financial statements for 19X3 store
		3	Lounge Doe, Inc., work papers for 19X1
		4	Lounge Doe, Inc., work papers for 19X2
		5	Lounge Doe, Inc., work papers for 19X3
		6	Doe's Kwik Stop work papers for 19X1
		7	Doe's Kwik Stop work papers for 19X2
		8	Doe's Kwik Stop work papers for 19X3
		9	Real Property, Ltd., work papers for 19X1
		10	Real Property, Ltd., work papers for 19X2
		11	Real Property, Ltd., work papers for 19X3
		12	Work papers 1040 for 19X1
		13	Work papers 1040 for 19X2
		14	Work papers 1040 for 19X3
W-14	Bookkeeper for Suzy's Women's Clothes	1	Books and records for 19X2
		2	Books and records for 19X3
W-15	First National Bank records custodian	1	Bank account records for 19X1
		2	Bank account records for 19X2

**Figure 22.1** Witness and exhibit list.

Witness Number	Witness	Exhibit Number	Exhibit Description		
W-15	First National Bank records custodian <i>(continued)</i>	3	Bank account records for 19X3		
		4	IRA account records for John Doe		
		5	IRA account records for Suzy Que		
		6	Trust account for sister		
		7	Trust account for brother 1		
		8	Trust account for brother 2		
		9	Trust account for parents		
		10	Mercedes Benz loan documents and payment schedule		
		11	Toyota loan documents and payment schedule		
		W-16	Credit card company records custodian	1	Credit card records for 19X1
				2	Credit card records for 19X2
3	Credit card records for 19X3				
W-17	Utility company records custodian	1	Billing and payment schedule for 19X1		
		2	Billing and payment schedule for 19X2		
		3	Billing and payment for schedule for 19X3		
W-18	Telephone company records custodian	1	Billing and payment schedule for 19X1		
		2	Billing and payment schedule for 19X2		
		3	Billing and payment schedule for 19X3		
W-19	Insurance company records custodian	1	Policy and payment schedule for 19X1		
		2	Policy and payment schedule for 19X2		
		3	Policy and payment schedule for 19X3		
		4	Policy and payment schedule for apartment building		
W-20	Church donation records custodian	1	Receipt schedule for 19X2		
		2	Receipt schedule for 19X3		
W-21	Auto dealership records custodian	1	Mercedes Benz purchase documents		
		2	Toyota purchase documents		
W-22	Apartment building tenants <sup>a</sup>	1	Lease agreements		
		2	Payment schedule		
W-23	Florida Mortgage Corp. records custodian	1	Mortgage documents		
		2	Payment schedule		
W-24	Maintenance company records custodian	1	Maintenance records		
		2	Payment schedule		
W-25	Administrator, state unemployment compensation office	1	earnings records		
W-26	Brokerage firm records custodian	1	Account application		
		2	Monthly statements		
		3	Purchase and sale confirmation slips		
W-27	Fraud examiner summary witness	1	Net worth schedule		
W-28	Jewelry store owner		Gold bullion invoice		
W-29	U.S. State Department consular officer	1	Bahamian public records		
W-30	County tax collector records custodian	1	Property tax bills		

<sup>a</sup>Each apartment building tenant is a witness along with the documentary evidence. For simplicity here, only one tenant and related evidence are shown.

**Figure 22.1** (continued)

the witness to review his previous statements or depositions and to examine the evidence that he previously provided. It often takes years from the time the witness is interviewed and evidence obtained until the time the trial takes place. Both physical evidence and statements should be kept in files that are secured. Original evidence should be kept in clear plastic envelopes and properly labeled. Under no circumstances should original evidence be marked on.

2. **Working copies.** Copies of original evidence and statements should be made for use as working copies. These copies can be marked on. If doing an indirect method, e.g., net worth or expenditure methods, these working copies should be filed according to the method used. In the case of the net worth method, the working copies should be kept by assets, liabilities, expenses, and known or nontaxable income. In the case of specific items, the files should be kept in chronological order. This can help the examiner in determining what items are missing or in identifying areas where more investigation work is required or additional evidence needs to be obtained.

## 22.12 Sample Report

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This section will provide a condensed version of a fraud examiner's report. Its primary purpose is to provide a guideline for the fraud examiner in preparing his or her investigative report. The basic elements of the fraud examiner's report are:

1. Fraud examiner's memorandum
2. Table of contents
3. Witness list
4. Schedule of losses or net worth/expenditure schedules with references to witnesses and evidence
5. Interview memoranda/depositions
6. Copies or photos of evidence

An example of a fraud examiner's report is given in Figure 22.2. Copies or photos of evidence are provided in this example.

The next part of the fraud examiner's report is the table of contents. An example is given in Figure 22.3.

The fraud examiner should list each witness and index him or her to the statements or depositions in the table of contents. Also, copies of documents should be listed and indexed. For simplicity, this is not done here.

The next section of the report is the witness list. The witness list was presented in an earlier section and will not be presented again here.

The next section shows the financial loss or the indirect method being used. The net worth schedule (Figure 22.4) shows the account description, the witness number, the evidence number, and a brief description of the evidence. The figures have been omitted since they are shown in an earlier chapter (see Chapter 8 for the RICO net worth schedule).

The next section of the fraud examiner's report should list the interviews and depositions of witnesses. In this case, most of the witnesses are records custodians. This section is important in that it gives the witnesses' statements. These statements can be

May 10, 19X4  
U.S./State Attorney  
Any County, U.S.  
Re: John Doe  
SSN: 000-00-0000  
DOB: 1/24/XX  
100 Alpha St.  
Any City, State XXXXX  
Case #: XXXXXXXX  
Criminal Drug Trafficking and Money Laundering, RICO  
FINAL REPORT

### HISTORY

John Doe is a 24-year-old man. He dropped out of the 10th grade. He has two brothers, a sister, and parents who are still living in the area. He has not married, but is currently living with a girlfriend, Suzy Que. John Doe has only had menial jobs during his career. Past employees have stated that John Doe is a talented boat mechanic. John Doe is considered the black sheep of the family. His parents are highly educated. His father was a doctor in Cuba, but now is working as a laboratory technician. His mother is a registered nurse. His brothers and sister are continuing their education. Doe has been seen on many occasions with Ramon Calderone, a known drug trafficker by local and federal law enforcement. John Doe, being young, is in excellent health. He has been seen jogging, swimming, and doing heavy lifting. Doe has not worked for any employer since 19X1. He quit his last job but gave no reason why to the employer. The employer offered to give him a \$1 per hour raise if he would stay. Doe refused. Doe lived with his parents up until the time that he purchased the house on 100 Alpha Street. John Doe uses pay telephones quite often. He visits his family regularly, but after meeting Suzy Que, he has spent less time visiting his family and more time courting Suzy. Doe does extensive travel around town and offshore. Suzy occasionally goes with Doe on his trips. It is documented that he has been to Europe, South and Central America, and various Caribbean islands. This case was instituted because of testimony of former drug pushers in court who identify John Doe as the supplier. The former drug pushers have all been convicted and are incarcerated.

### TYPE OF CASE

This is a net worth case. The purpose of the net worth method is to determine Doe's alleged illegal gains from his drug trafficking and money laundering activities. In addition, it will serve as a basis for both civil and criminal forfeitures.

**Figure 22.2** Investigation report.

## EVIDENCE

Since this is a net worth case, most of the witnesses are records custodians who have records of transactions conducted with the subject. Some of the records custodians have personal knowledge of and possible friendships with the subject. The key witness will be the summary witness, who will have to summarize the financial evidence introduced into court. To place the subject in the drug trafficking and money laundering activities, witnesses will have to testify that they purchased drugs from or on behalf of the subject. Unfortunately, all the drug witnesses have been incarcerated for drug trafficking, which lends them to lack of creditability. Ramon Calderone is an indicted drug trafficker who has fled the U.S. It is well documented that the subject had a close association with Calderone.

## INTENT

The use of the net worth method of proving illegal gains shows that the subject did not fully hide his illegal gains. The subject maintained offshore bank accounts to hide his illegal gains. The subject did not operate his legitimate businesses on a day-to-day basis like normal businessmen. He traveled to offshore countries where he did not have any legitimate business dealings. He made cash deposits exceeding \$10,000, and the bank did not file the appropriate CTRs because of inside contacts. He made various investment purchases in cash in order not to leave a paper trail. Mortgages were obtained from offshore companies with no record of repayments. The offshore mortgage company is not registered in the U.S., nor does it do any other business activities. The girlfriend is known to be a drug user by her co-workers and friends. Wiretapped conversations of the subject discussing drug deals show that he is involved in drug trafficking. There were many telephone calls made to offshore tax havens, many of which were to banks.

## DEFENSES

The most common defense in this type of case will be the cash hoard. In this case, the fact that the subject is young and was unable to accumulate enough cash to make the investments and expenditures that he made negate the cash hoard story. His income prior to the prosecution period was very small. His relatives were financially unable to provide the funds for the subject to make the investments and expenditures. Of course, the defense will try to discredit the witnesses who had drug dealings with the subject. The net worth method of proving income will overcome these defenses.

**Figure 22.2** (continued)

FINANCIAL DATA

See the attached net worth schedule regarding the illegal or unidentified gains of the subject. The fees and costs of this investigation are as follows:

RECOMMENDATIONS

It is recommended that the the U.S. attorney prosecute the subject for drug trafficking and money laundering under the following federal statutes: 18 USC 1956, 1963, and 21 USC 855. If the U.S. attorney declines to prosecute, then the state attorney should prosecute under state statute XXXX.

Fraud Examiner  
 Copy to:  
 File  
 Case Detective

**Figure 22.2** (continued)

TABLE OF CONTENTS

1. Witness List
2. Net Worth Schedule
3. Witness Interviews and Depositions
4. Copies or Photos of Evidence

**Figure 22.3** Table of contents sample.



Account	Witness Number	Exhibit Number	Description
1. Cash on hand	W-1	1	Property receipt
2. Cocaine, 2 kilos	W-1	2	Property receipt and lab report
3. First National Bank	W-15	1–3	Bank account records
4. First National Bank	W-15	1–3	Bank account records
5. Business cash in bank	W-14	1, 2	Books and records
	W-15	13, 14	Bank account records 19X2–X3
6. Accounts receivable	W-13	1, 2	Financial statements
	W-14	1, 2	Work papers
7. Inventory	W-13	1, 2	Financial statements
	W-14	1, 2	Work papers
8. Business assets	W-13	1, 2	Financial statements
	W-14	1, 2	Work papers
9. Security system	W-11	1, 2	Contract and payment schedule
10. Electronic Equipment	W-10	1	Purchase invoice
11. Appliances	W-9	1	Purchase invoice
12. Fixtures	W-7	1	Purchase invoice
13. Furniture	W-4	1	Purchase invoice
14. Cabinets	W-5	1	Purchase invoice
15. Paintings	W-6	1	Purchase invoice
16. Pool and tennis court	W-8	1, 2	Contract and payment schedule
17. 100 Alpha Street	W-2	1	Deed and mortgage
18. 100 Brave Street	W-2	2	Deed and mortgage
19. Gold bullion	W-1	1	Case detective and property receipt
	W-28	1	Purchase invoice
20. Lounge Doe, Inc.	W-12	4–6	1120 tax returns
	W-13	3–5	Work papers
21. Doe Kwik Stop	W-12	7–9	1120S tax return
	W-13	6–8	Work papers
22. Real property	W-12	10–12	1065 tax returns
	W-13	9–11	Work papers
23. Mercedes Benz	W-21	1	Purchase documents
24. Toyota	W-21	2	Purchase documents
25. IRA — John Doe	W-15	4	Bank records
26. IRA — Suzy Que	W-15	5	Bank records
27. Bahamas residence	W-29	1	Public records
28. Mercedes loan	W-15	10	Loan documents
29. Toyota loan	W-15	11	Loan documents
30. Credit card	W-16	1–3	Credit card records
31. Accounts payable	W-13	1, 2	Financial statements and work papers
	W-14	1, 2	Books and records
32. Florida Mortgage Corp.	W-23	1, 2	Mortgage documents and payment schedule
33. Business bank loan	W-15	12	Loan documents
34. Purchases	W-13	1, 2	Financial statements and work papers
	W-14	1, 2	Books and records
35. Inventory change	W-13	1, 2	Financial statements and work papers
	W-14	1, 2	Books and records
36. Cost of sales	W-13	1, 2	Financial statements and work papers
	W-14	1, 2	Books and records
37. Advertising	W-13	1, 2	Financial statements and work papers
	W-14	1, 2	Books and records
38. Loan interest	W-13	1, 2	Financial statements and work papers

**Figure 22.4** John Doe's net worth schedule witness list.

Account	Witness Number	Exhibit Number	Description
39. Insurance	W-14	1, 2	Books and records
	W-13	1, 2	Financial statements and work papers
	W-14	1, 2	Books and records
40. Professional fees	W-13	1, 2	Financial statements and work papers
	W-14	1, 2	Books and records
41. Office expenses	W-13	1, 2	Financial statements and work papers
	W-14	1, 2	Books and records
42. Rent expenses	W-13	1, 2	Financial statements and work papers
	W-14	1, 2	Books and records
43. Repairs	W-13	1, 2	Financial statements and work papers
	W-14	1, 2	Books and records
44. Supplies	W-13	1, 2	Financial statements and work papers
	W-14	1, 2	Books and records
45. Taxes and license	W-13	1, 2	Financial statements and work papers
	W-14	1, 2	Books and records
46. Utilities	W-13	1, 2	Financial statements and work papers
	W-14	1, 2	Books and records
47. Wages	W-13	1, 2	Financial statements and work papers
	W-14	1, 2	Books and records
48. Miscellaneous	W-13	1, 2	Financial statements and work papers
	W-14	1, 2	Books and records
49. Florida Mortgage Corp.	W-23	1, 2	Mortgage documents and payment schedule
50. Utilities	W-17	1-3	Billing and payment schedules
51. Telephone	W-18	1-3	Billing, payments, and toll schedules
52. Insurance	W-19	1-3	Policy and payment schedule
53. Life insurance	W-3	1, 2	Policy and payment schedule
54. Auto loan interest	W-15	10, 11	Bank loan documents and payment schedule
55. Income tax withheld	W-12	1-3	1040 tax return
56. Property taxes	W-13	12, 13	Property tax bills
	W-30	1	Assessment and payments
57. Credit card	W-16	1-3	Credit card statements
58. Church donations	W-20	1, 2	Payment receipts
59. Trust funds	W-15	6-9	Bank records and trust agreements
60. Loss — XYZ stock	W-26	1-3	Brokerage records
61. Wages/salaries	W-12	1-3	W-2 records
	W-13	12-14	Work papers
	W-12	1	1099 records
62. Dividends	W-12	1	1099 records
	W-13	3, 12	Work papers
63. Rental income	W-12	1-3	1040 tax returns
	W-12	9-11	1065 tax returns
64. Gain — ABC stock	W-26	1-3	Brokerage records
65. IRA interest	W-15	4	Bank records
66. IRA interest	W-15	5	Bank records
67. Tax refunds	W-12	1-3	IRS payment records
68. Sale — XYZ stock	W-26	1-3	Brokerage records
69. Business income	W-13	1, 2	Financial statements and work papers
	W-14	1, 2	Books and records

Figure 22.4 (continued)

in the form of casual statements, formal statements, or depositions. Some witnesses may have more than one statement. Figure 22.5 shows an example of the index of interviews and depositions.

1. Case detective	Police reports
2. Administrator, public records	Interview memorandum
3. Records custodian, life insurance company	Interview memorandum
4. Records custodian, furniture company	Interview memorandum
5. Records custodian, cabinet company	Interview memorandum
6. Records custodian, art dealer	Interview memorandum
7. Records custodian, fixture company	Interview memorandum
8. Records custodian, pool and tennis contractor	Interview memorandum
9. Records custodian, appliance dealer	Interview memorandum
10. Records custodian, electronics store	Interview memorandum
11. Records custodian, security system dealer	Interview memorandum
12. IRS representative	Interview memorandum
13. I.M. Balance, CPA	Sworn statement and interview memorandum
14. Bookkeeper, Suzy's Women's Clothes	Interview memorandum
15. Records custodian, First National Bank	Interview memorandum
16. Records custodian, credit card company	Interview memorandum
17. Records custodian, utility company	Interview memorandum
18. Records custodian, telephone company	Interview memorandum
19. Records custodian, insurance company	Interview memorandum
20. Records custodian, Christian church	Interview memorandum
21. Records custodian, auto dealership	Interview memorandum
22. Tenants, apartment building	Interview memorandum
23. Records custodian, Florida Mortgage Corp.	Interview memorandum
24. Records custodian, maintenance company	Interview memorandum
25. Administrator, State Unemployment Compensation Office	Interview memorandum
26. Records custodian, brokerage firm	Interview memorandum
27. Fraud examiner	Examiner's report
28. Records custodian, jewelry store	Interview memorandum
29. Consular officer, U.S. State Department	Interview memorandum
30. Records custodian, county tax collector	Interview memorandum

**Figure 22.5** Index of interviews/depositions.

Figure 22.6 is an example of a records custodian memorandum of interview. An example of a witness-sworn statement follows in Figure 22.7.

Date: February 1, 19X4  
Present: Records Custodian  
Case Detective/Agent  
Fraud Examiner  
Place: XYZ Auto Dealership  
300 Main Street  
Any City, State XXXXX

Mr. Paul Jones is the records custodian for the XYZ Auto Dealership. Mr. Jones has never met the subject. He only processes the paperwork that the salesmen provide when customers purchase new or used cars.

Mr. Jones provided information about the regular course of business in keeping records. These procedures are as follows:

1. The salesman completes the sales contract and has the customer sign the contract. The salesman also obtains a down payment or full payment.
2. The credit department gets approval from a local financial institution for financed purchases after the salesman gets a signed contract and down payment. Once approved, the customer and the financial institution get a copy of the contract. The dealership keeps a copy of the contract. It is sent to the accounting department for processing.
3. The accounting department gets a copy of the contract for processing. The sale is recognized through the books after it has been approved by the financial institution. Mr. Jones is the controller of the dealership and the official records custodian. After the contract and sale are recognized, the contract is filed by customer name and stored.

Mr. Jones provided the following records of purchase:

1. The purchase and installment sale contract. This document shows the purchase, down payment, principal financed, rate of interest, payments, and term.
2. A copy of the sales journal showing the receipt of the down payment.
3. A copy of the sales journal showing the payment by the financial institution.
4. A copy of the delivery receipt, which shows that the customer picked up the automobile 4 days after the contract was signed.
5. A copy of the maintenance contract and a record of service done on the vehicle while under warranty.

**Figure 22.6** Memorandum of interview sample.

I, I.M. Balance, CPA, provide the following statement about my client John Doe.

1. I obtained John Doe as a client by a referral. I don't recall who referred John Doe to me.
2. I prepared John Doe's individual tax returns, 1040s, for the years 19X1 and 19X3. I obtained the data to prepare John Doe's individual tax return for 19X2, but did not prepare it because I was missing some data. I don't recall what data I was missing.
3. I prepared the 1120 federal corporate income tax returns for 19X1, 19X2, and 19X3 for Lounge Doe, Inc. These returns were prepared based on the bank statements, cancelled checks, accounts payable, inventory, and asset listings, which were provided by the client. These items were processed by generating a general journal, general ledger, trial balance, and financial statements. The financial statements were used to prepare the corporate tax return.
4. I prepared the 1120S federal corporate income tax returns for 19X1, 19X2, and 19X3 for Kwik Stop, Inc. These returns were prepared based on the bank statements, cancelled checks, accounts payable, inventory, and asset listings, which were provided by the client. These items were processed by generating a general journal, general ledger, trial balance, and financial statements. The financial statements were used to prepare the corporate tax return.
5. I prepared the 1065 federal partnership income tax returns for 19X1, 19X2, and 19X3 for Real Property, Ltd. These returns were prepared based on the bank statements, cancelled checks, closing statements, and mortgage information. These items were processed by generating a general journal, general ledger, trial balance, and financial statements. The financial statements were used to prepare the partnership return. I never met the other partner, Ramon Calderone. All my dealings were with John Doe. Doe was given a copy of the return so his partner could complete his individual tax return.
6. I was retained by John Doe to do a certified audit on Suzy's Women's Clothes store. This is a sole proprietorship. John Doe is the sole owner. His girlfriend and Betsy Low took care of the books and managed the store. They had about 8 to 10 employees at any one time. Suzy Que and Betsy Low received a salary to operate the business. They maintained a general journal and general ledger. In addition, they maintained accounts receivable, accounts payable, and purchase journals. I used these journals to prepare a trial balance and produce financial statements. I also made test of the records in accordance with General Accepted Accounting Principles and General Accepted Audit Standards as promulgated by the AICPA. In addition, I prepared a Schedule C for John Doe for reporting on his individual income tax return. John Doe retained me to do the certified audit and oversee operations since he would be busy in his other business ventures.
7. I advised John Doe to obtain an Individual Retirement Account. In addition, I have counseled John Doe on taxes, management of businesses, and various investments. I advised John Doe to acquire Kwik Stop, Inc. This advice was based on the fact that John Doe wanted to supply boaters with fast food items and other supplies. Doe obtained a boat that he said was going to be used for this purpose. I never observed the boat.

**Figure 22.7** Statement sample.

8. John Doe is a friendly and personable individual. He is young and has many innovative ideas that I thought were good. He followed my advice on his business decisions. We worked well together.

I have read the foregoing statement. I fully understand that this statement is true, accurate, and complete to the best of my knowledge. I made this statement freely and voluntarily, without any threats or rewards, or promises of rewards having been made to me in return for it.

/s/I.M. Balance

Witness signature Date

Witness signature

**Figure 22.7** (continued)

### 22.13 Summary

Maintaining proper files and producing reports are very important. They help the fraud examiner and his client in evaluating the case. The fraud examiner's report is the final product. It reflects the capabilities of the examiner. Sloppy reports indicate that the examiner is sloppy. The report also helps the examiner. He may find that he is missing evidence. If so, then he has to obtain it. Additionally, the report helps the examiner in trial. First, it tells him what evidence must be introduced into court before his summaries can be used. Second, it tells him exactly what he is going to testify about and gives the basis of his opinion as an expert witness.





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## 23.1 Introduction

Audit programs are procedures to be followed by accountants and auditors in the course of their examination of a business entity. The examiner must collect various kinds of evidence relating to the propriety of the recording of economic events and transactions. Audit programs are guidelines for the examiner in obtaining and collecting financial evidence. The auditor must collect and analyze evidence to support his attest function regarding the business entity's financial condition. The fraud examiner must collect and analyze evidence to uncover possible fraud by employees, management personnel, or outsiders. While the auditor is primarily interested in obtaining evidence to support the attest function, the fraud examiner must obtain evidence that will convince a jury of peers that a certain individual has committed an economic crime. The evidence required to convince a jury and to be admissible in court is much greater than that needed to support the attest function. This chapter gives the minimum general guidelines that a fraud examiner must follow. The fraud examiner's judgment should always overrule any audit program.

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## 23.2 General Guidelines

The fraud examiner, like other accountants and auditors, must have a general outline of the engagement that should be followed:

1. **Industry data.** The fraud examiner must know how the industry operates. He should obtain as much data, both financial and nonfinancial, as possible.
2. **Financial analysis.** The fraud examiner should make various comparisons and analysis to identify possible fraud areas.
3. **Internal controls.** The fraud examiner must review the internal controls in order to identify problem areas.
4. **Evidence gathering.** This is the stage where the fraud examiner searches and obtains evidence of possible fraud activity.
5. **Evaluation.** The fraud examiner must analyze evidence to confirm whether fraud was actually committed.
6. **Report.** The fraud examiner must report his findings to the appropriate parties.



### 23.3 Industry Data

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Companies that are in the same business operate and report financial and nonfinancial data in a similar manner. This is particularly true with the Internal Revenue Service, since its regulations set forth tax principles that various industries must follow. The Internal Revenue Service annually publishes industry data and statistics. There are also other governmental and publishing companies that provide industry data (see Chapter 15). Comparing a business entity with others can identify problem areas, i.e., inventory, receivables, payables, sales, etc.

### 23.4 Financial Analysis

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Financial statements should be analyzed to determine trends and relationships and compared with nonfinancial data in order to identify significant irregularities and unexplained fluctuations. This can help in identifying possible areas where fraud can occur. There are three types of techniques that are commonly used:

1. Ratio analysis
2. Vertical analysis
3. Horizontal analysis

#### 23.4.1 Ratio Analysis

Ratios are useful in determining if financial statements are reasonable (Table 23.1). Ratios can identify material fluctuations. These fluctuations must be researched for a reasonable explanation. Significant fluctuations from period to period can be a result of changing economic conditions, management strategy and policy, errors in record keeping, or fraud. The cause must be determined. Fraud could be one cause, but fluctuations are not proof that it occurred. Company ratios should be compared to industry statistics and data.

**Table 23.1 Ratio Analysis**

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1. Current ratio =  $\frac{\text{Current assets}}{\text{Current liabilities}}$
2. Quick ratio =  $\frac{\text{Cash} + \text{Securities} + \text{Receivables}}{\text{Current liabilities}}$
3. Cash ratio =  $\frac{\text{Cash} + \text{Securities}}{\text{Current liabilities}}$
4. Accounts receivable turnover =  $\frac{\text{Sales}}{\text{Average receivables}}$
5. Days to collect receivables =  $\frac{365}{\text{Accounts receivable turnover}}$

6. Inventory turnover =  $\frac{\text{Cost of goods sold}}{\text{Average inventory}}$
7. Days to sell inventory =  $\frac{365}{\text{Inventory turnover}}$
8. Days to convert inventory to cash = Days to sell inventory + Days to collect cash receivables
9. Debt-to-equity ratio =  $\frac{\text{Total liabilities}}{\text{Total equity}}$
10. Times interest earned =  $\frac{\text{Net income}}{\text{Interest expense}}$
11. Profit margin ratio =  $\frac{\text{Net income}}{\text{Net sales}}$
12. Asset turnover =  $\frac{\text{Net sales}}{\text{Average total assets}}$
13. Return on equity =  $\frac{\text{Net income}}{\text{Average equity}}$
14. Earnings per share =  $\frac{\text{Net income}}{\text{Number of shares of stock}}$
15. Gross profit % =  $\frac{(\text{Cost of sales}) \times 100}{\text{Sales}}$

### 23.4.2 Vertical Analysis

This method is used in comparing items on the balance sheet and income statement by reflecting all components in terms of percentages. For the balance sheet, total assets are assigned 100%. For the income statement, net sales are assigned 100%. All other items on both the balance sheet and income statement are shown as a percentage of those two figures, respectively.

### 23.4.3 Horizontal Analysis

This method is used to compare percentage changes in the balance sheet and income statement from one period to the next. Horizontal analysis compares both the dollar amount and change percentage from year to year. Any unusual fluctuation must be investigated to determine if it is due to fraud or some other cause. It is by no means proof that fraud exists; it is only an indication that fraud may exist.

### 23.4.4 Nonfinancial Data

Financial statements should reflect what actually happened. If inventory and fixed assets are shown on the financial statements, then these assets should be observable. There is a

direct relationship between financial statements and the physical goods and movement of assets. Comparing financial statement data with nonfinancial data is a good method of detecting fraud. The fraud examiner should make further inquiries when things appear out of order or sequence. Some things that should be reviewed are:

1. If sales increase, then accounts receivable should likewise increase.
2. If sales increase, then inventory should increase.
3. If profits increase, then cash should increase.
4. If sales increase, then the cost of outbound freight should increase.
5. If purchases increase, then the cost of inbound freight should increase.
6. If manufacturing volume increases, then per-unit costs should decrease.
7. If manufacturing volume increases, then scrap sales and purchase discounts should increase.
8. If inventory increases, then storage space must be available to contain it.
9. When sales increase, there are usually other expense accounts that increase in the same proportion.
10. Over-aged receivables could indicate not only slow payment by the customer, but also possible fraud. The receivable could have been received but not recorded.

### **23.4.5 Cash Flow**

A cash flow statement can identify potential fraud. The cash flow statement identifies how a company uses and applies its funds and explains the net increase or decrease in cash during the period. It is particularly useful for identifying problem areas. There is a close relationship between the balance sheet and income statement. The cash flow statement ties the balance sheet and income statement together in much detail. There are many cases where fraudulent balance sheets and income statements were prepared. When a cash flow statement was prepared, it was discovered that there were discrepancies. These discrepancies help confirm that the financial statements are incorrect and can identify fraudulent areas.

#### **23.4.5.1 Cash Flow Statement**

The cash flow statement can be very complicated. Its primary purpose is to explain the increase in cash accounts from one period to another. The outline in Figure 23.1 gives general steps in preparing a cash flow statement.

#### **23.4.5.2 Cash Flow Theory**

The theory behind the cash flow statement is to start with the net income from operations. The first step is to convert the net income from the income statement into the net cash flow from operations. Eliminating the noncash items on the income statement does this. The second step is to add other sources of cash flow. This is additional cash that comes from other sources other than normal operations. The third step is to identify cash expenditures that do not affect current income statement operations. After the net income from operations is adjusted for noncash items, the total other cash sources are added and the other cash expenditures are subtracted from the net cash from operations. This gives the net increase in the cash accounts. This should equal the net increase/decrease in the total

Cash flow from operations
Net income
Adjustments to net income
Depreciation expense
Amortization expense
Increase/decrease receivables
Increase/decrease inventory
Increase/decrease payables
Net cash inflow from operations
Other sources of funds
Sales of fixed assets
Borrowing from banks, etc.
Capital investment
Application of funds
Purchase of fixed assets
Debt reduction
Dividends
Net increase/decrease in cash
Should equal the net increase/decrease in cash accounts

**Figure 23.1** Cash Flow Statement

cash accounts. If it does not, then the financial statements will have to be further analyzed to determine the area where the potential fraud has occurred.

### **23.4.5.3 Net Income Adjustments**

There are five types of items that will be used to adjust the net income from operations:

1. Depreciation
2. Amortization
3. Receivables
4. Payables
5. Inventory

The theories for these adjustments are further explained below.

**23.4.5.3.1 Depreciation.** This is a noncash expense. It is solely a journal entry by accountants to expense in a systematic method of writing off the cost of fixed assets on the balance sheet. Therefore, the depreciation expense shown as an expense must be added back to the net income from operations.

**23.4.5.3.2 Amortization.** This expense does not involve the use of cash. It is an entry used to systematically write off the cost of some tangible or intangible asset, i.e., leasehold improvements, organization costs, goodwill, and various prepaid expenses.

**23.4.5.3.3 Receivables.** Many business enterprises keep their books on the accrual method of accounting. The accrual method requires that sales be recognized when they

occur and not when the funds are collected. This results in the business enterprise having an asset called accounts receivable. The Internal Revenue Service and the American Institute of CPAs require many business enterprises to be on the accrual method of accounting. The sales accounts have to be adjusted for noncash sales. Finding the difference in accounts receivable between the beginning and ending of the period can do this. If the receivables increase, then the net income will have to be decreased by that difference. If the receivables decrease, then the net income will have to be increased by that difference.

**23.4.5.3.4 Payables.** Payables, like accounts receivable, recognize expenses when they are incurred and not when they are paid. Again, this is the accrual method of accounting. The expenses on the income statement will have to be adjusted for noncash items. This is done by getting the difference between the beginning and ending balances in the accounts payable for the period. If the payables increase for the period, then the net income will have to be increased. Conversely, if the payables decrease for the period, then the net income will have to be decreased.

**23.4.5.3.5 Inventory.** Inventories are goods that a business enterprise has on hand that are not sold. When inventory is sold, it is expensed to the cost of goods sold on the income statement. Inventory can be purchased in a prior period and sold in the current period. This causes an outlay of cash in the prior period but not the current period. The current period has to be adjusted for inventory and cost of goods sold in a manner that does not require any cash outlay. This can be done by finding the difference in inventory at the beginning and end of the period. If the inventory increases over the period, then net income should be increased by the difference. Conversely, if the inventory decreases over the period, then the net income should be decreased by the difference.

## 23.5 Internal Controls

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Internal control describes an entity's organization and system of procedures that provide reasonable assurance that errors or irregularities will be prevented or detected on a timely basis. The objectives of internal controls are:

1. Transactions are executed in accordance with management's authorization.
2. Transactions are properly recorded. This entails that the transaction has substance (existence) and is properly valued, classified, and recorded in the proper period.
3. Assets are safeguarded. This entails restricting access to assets and segregation of duties.
4. Actual assets are required to be periodically compared to accounting records.

### 23.5.1 Basic Concepts

There are 10 basic concepts on internal controls. The first four concepts relate to accounting controls. The last six relate to essential characteristics of internal controls. These concepts are outlined below.

### **23.5.1.1 Management Responsibility**

Management must establish, maintain, supervise, and modify, as required, a system of internal controls for the company. It should have a proper attitude. Setting a good example for others to follow can do this. Management can issue a code of conduct, provide training, and enforce policy. If employees see management being dishonest, then they will commit fraudulent acts.

### **23.5.1.2 Reasonable Assurance**

The costs of controls should not exceed their expected benefit. Yet, there must be controls in place that can detect fraud or other irregularities. Organizational structure that clearly defines lines of responsibility and authority can deter internal fraud. An audit committee that reports to the board of directors is an important control element. The audit committee should control both financial and operational audit functions as well as be responsible for security. It should never be controlled by or report to management.

### **23.5.1.3 Methods of Data Processing**

Most business enterprises today use computers. This primarily is due to the low cost of both hardware and software. Computers also save time and costs in processing financial information. However, computer systems provide internal control problems. Transaction trails may exist for a short period or only in computer-readable form. Program errors are less frequent. Computer controls may become more important than segregation of functions. It also becomes more difficult to detect unauthorized access to the computer system. There is less documentation of initiation and execution of transactions. Manual control procedures using computer output are dependent on the effectiveness of computer controls.

### **23.5.1.4 Limitations**

Auditors should not rely entirely on internal control, even if it seems outstanding, since the best system may break down due to misunderstandings, mistakes in judgment, carelessness, collusion, and being overridden by management.

### **23.5.1.5 Segregation of Functions**

The segregation of functions is an essential element of internal control. The basic premise is that no employee performs more than one function. The functions of record keeping, custodianship, authorization, and operations should always be kept separate.

### **23.5.1.6 Personnel**

Personnel policies are an important ingredient for an internal control system. A business enterprise should obtain reliable employees. This can be done by screening prospective employees. References should be verified as to both competence and trustworthiness. Employees in responsible positions should be bonded. Management should supervise employees in a professional manner. It should not be overbearing or critical, intimidate, instill fear, or treat employees unfairly. This will encourage employee fraud. If management encourages team effort and ideas and gives recognition for good performances, then employee fraud is greatly reduced. Employees should be required to take vacations.

### **23.5.1.7 Access to Assets**

Physical control over assets should be the responsibility of a custodian. This custodian should never have access to financial records. However, the custodian should maintain records of assets regarding physical description, location, and condition.

### **23.5.1.8 Comparison of Accountability with Assets**

A control procedure of periodically comparing financial records with physical observation is an important internal control element. This should be done by an independent reviewing party. The reviewing party should not have responsibility for either record keeping or custodianship. Any discrepancies should be investigated.

### **23.5.1.9 Execution of Transactions**

Every transaction should be authorized. The business enterprise should set up policies and guidelines that should be followed. Larger transactions should have various levels of authorization.

### **23.5.1.10 Recording of Transactions**

There should be standardized procedures for recording transactions. These controls must ensure that fraudulent or unauthorized transactions are not recorded. Ensure that authorized transactions are properly included, valued, and classified, at the proper time. Any exceptions should be investigated immediately. Transactions should involve more than one employee. Proper records should be maintained. An audit trail must be maintained at all times. Audit evidence must be available for inspection and review. Source documents, i.e., invoices, purchase orders, and checks, should be prenumbered and accounted for periodically.

## **23.5.2 Internal Control Checklist**

The following checklist gives an outline of internal controls that most businesses should have, depending on the size of the company (Table 23.2). For small businesses, many of the internal controls listed below are not applicable. Some of the internal controls should be used in the actual audit process.

**Table 23.2 Internal Control Checklist**

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- A. General controls
  - 1. Chart of accounts (both past and current)
  - 2. Accounting procedures manual
  - 3. Organizational chart showing definite responsibilities
  - 4. Review of journal entries
    - a. No ledger references
    - b. No journal entries for ledger entries
  - 5. Standard journal entries
  - 6. Use of prenumbered forms
  - 7. Supporting documents for journal entries
  - 8. Limited access to authorized personnel
  - 9. Rotation of accounting personnel

**Table 23.2** (continued)

- 
10. Required vacations
  11. System of reviews
  12. Separation of record keeping from operations
  13. Record retention policy and procedures
  14. Bonding of employees
  15. Conflict of interest policies
    - a. Written policy
    - b. Promulgation procedures
- B. Cash on hand
1. Impress system
  2. Reasonable amount
  3. Completeness of vouchers
  4. Custodian responsibility
  5. Reimbursement checks to order of custodian
  6. Surprise audits
  7. No employee check cashing
  8. Physical security
  9. Custodian has no access to receipts
  10. Custodian has no access to accounting records
- C. Cash receipts
1. Listing of mail receipts
  2. Special handling of postdated checks
  3. Daily deposits
  4. Cash custodians bonded
  5. Cash custodians apart from negotiable instruments
  6. Bank accounts properly authorized
  7. Proper handling of returned NSF items
  8. Comparison of duplicate deposit slip with cash book
  9. Comparison of duplicate deposit slip with customer subledgers
  10. Banks instructed not to cash checks to company
  11. Control of cash from other sources
  12. Separation of cashier personnel from accounting duties
  13. Separation of cashier personnel from credit duties
  14. Use of cash registers
  15. Retention and safekeeping of register tapes
  16. Numbered cash receipts tickets
  17. Outside salesmen cash controls
  18. Daily reconciliation of cash collections
- D. Cash disbursements
1. Numbered checks
  2. Support for check signature
  3. Limited authorization to sign checks



**Table 23.2** (continued)

- 
4. No signing of blank checks
  5. All checks accounted for
  6. Detailed listing of checks
  7. Mutilation of voided checks
  8. Proper authorization of personnel signing checks
  9. Control over signature machines
  10. Check listing compared to cash book
  11. Control over bank transfers
  12. Checks not payable to cash
  13. Physical security over unused checks
  14. Cancellation of supporting documents
  15. Control over long outstanding checks
  16. Reconciliation of bank account(s)
  17. Independence of person reconciling bank statements
  18. Bank statement direct to person reconciling bank statements
  19. No access to cash records or receipts by check signers
- E. Investments
1. Proper authorization of transactions
  2. Under control of custodian
  3. Custodian bonded
  4. Custodian separate from cash receipts
  5. Custodian separate from investment records
  6. Safe deposit box
  7. Record of all safe deposit visits
  8. Access limited to safe deposit box
  9. Presence of two required for access
  10. Periodic reconciliation of detail with control
  11. Record of all aspects of all securities
  12. Brokerage advice and statements
  13. Periodic internal audit
  14. Securities in name of company
  15. Segregation of collateral
  16. Physical control of collateral
  17. Periodic appraisal of collateral
  18. Periodic appraisal of investments
- F. Accounts receivable and sales
1. Sales orders prenumbered
  2. Credit approval
  3. Credit and sales department independent
  4. Control of back orders
  5. Sales order and sales invoice comparison
  6. Shipping invoices prenumbered
  7. Names and addresses on shipping orders

**Table 23.2** (continued)

- 
8. Review of sales invoices
  9. Control over returned merchandise
  10. Credit memoranda prenumbered
  11. Matching of credit memorandum receiving reports
  12. Control over credit memoranda
  13. Control over scrap sales
  14. Control over sales to employees
  15. Control over COD sales
  16. Sales reconciled with cash receipts and accounts receivable
  17. Sales reconciled with inventory change
  18. Accounts receivable statements to customers
  19. Periodic preparation of aging schedule
  20. Control over payments of written-off receivables
  21. Control over accounts receivable write-offs, proper authorization
  22. Control over accounts receivable written off, review for possible collection
  23. Independence of sales, accounts receivable, receipts, billing, and shipping
- G. Notes receivable
1. Proper authorization of notes
  2. Detailed records of notes
  3. Periodic detail to control comparison
  4. Periodic confirmation with makers
  5. Control over notes discounted
  6. Control over delinquent notes
  7. Physical safety of notes
  8. Periodic count of notes
  9. Control over collateral
  10. Control over revenue from notes
  11. Custodian of notes independent from cash and record keeping
- H. Inventory and cost of sales
1. Periodic inventory
  2. Written inventory instructions
  3. Counts by noncustodians
  4. Controls over count tags
  5. Control over inventory adjustments
  6. Use of perpetual records
  7. Periodic comparison of general ledger and perpetual records
  8. Investigation of discrepancies
  9. Control over consignment inventory
  10. Control over inventory stored at warehouse
  11. Control over returnable containers with customers
  12. Receiving reports prepared
  13. Receiving reports in numerical order
  14. Independence of custodian from record keeping

**Table 23.2** (continued)

- 
15. Adequacy of insurance
  16. Physical safeguard against theft
  17. Physical safeguard against fire
  18. Adequacy of cost system
  19. Cost system tied into general ledger
  20. Periodic review of overhead rates
  21. Use of standard costs
  22. Use of inventory requisitions
  23. Periodic summaries of inventory usage
  24. Control over intercompany inventory transfers
  25. Purchase orders prenumbered
  26. Proper authorization for purchases
  27. Review of open purchase orders
  28. Purchasing agents bonded
  29. Three or more bids or quotes
- I. Prepaid expenses and deferred charges
1. Proper authorization to incur
  2. Authorization and support of amortization
  3. Detailed records
  4. Periodic review of amortization policies
  5. Control over insurance policies
  6. Periodic review of insurance needs
  7. Control over premium refunds
  8. Beneficiaries of company policies
  9. Physical control of policies
- J. Intangibles
1. Authorization to incur
  2. Detailed records
  3. Authorization to amortize
  4. Periodic review of amortization
- K. Fixed assets
1. Detailed property records
  2. Periodic comparison with control accounts
  3. Proper authorization of acquisition
  4. Written policies for acquisition
  5. Control over expenditures for self-construction
  6. Use of work orders
  7. Individual asset identification plates
  8. Written authorization for sale
  9. Written authorization for retirement
  10. Physical safeguard from theft
  11. Control over fully depreciated assets

**Table 23.2** (continued)

- 
12. Written capitalization and expense policies
  13. Responsibilities charged for asset and depreciation records
  14. Written depreciation records
  15. Detailed depreciation records
  16. Depreciation adjustments for sales and retirements
  17. Control over intercompany transfers
  18. Adequacy of insurance
  19. Control over returnable containers
- L. Accounts payable
1. Designation of responsibility
  2. Independence of accounts payable personnel from purchasing, cashier, and receiving functions
  3. Periodic comparison of detail and control
  4. Control over purchase returns
  5. Clerical accuracy of vendor's invoice
  6. Matching of purchase orders, receiving reports, and vendor invoices
  7. Reconciliation of vendor statements with accounts payable detail
  8. Control over debit memos
  9. Control over advance payments
  10. Review of unmatched receiving reports
  11. Mutilation of supporting documents at payment
  12. Review of debit balances
  13. Investigation of discounts not taken
- M. Accrued liabilities and other expenses
1. Proper authorization for expenditures and concurrence
  2. Control over partial deliveries
  3. Postage meter
  4. Purchasing department
  5. Verification of invoices
  6. Impress cash account
  7. Detailed records
  8. Independence from general ledger and cashier functions
  9. Periodic comparison with budget
- N. Payroll
1. Authorization to employ
  2. Personnel data files
  3. Tax records
  4. Time clock
  5. Review of payroll calculations
  6. Impress payroll account
  7. Responsibility for payroll records
  8. Compliance with labor statutes

**Table 23.2** (continued)

- 
9. Distribution of payroll checks
  10. Control over unclaimed wages
  11. Profit-sharing authorization
  12. Responsibility for profit-sharing computations
  13. Responsible employees bonded
  14. Employee benefit plans comparison with tax records
- O. Long-term liabilities
1. Authorization to incur
  2. Executed in company name
  3. Detailed records of long-term debt
  4. Reports of independent transfer agent
  5. Reports of independent registrar
  6. Otherwise adequate records of creditors
  7. Control over unissued instruments
  8. Signers independent of each other
  9. Adequacy of records of collateral
  10. Periodic review of debt agreement compliance
  11. Record keeping of detachable warrants
  12. Record keeping of conversion features
- P. Shareholders' equity
1. Use of registrar
  2. Use of transfer agent
  3. Adequacy of detailed records
  4. Comparison of transfer agent's report with records
  5. Physical control over blank certificates
  6. Physical control over treasury certificates
  7. Authorization for transactions
  8. Tax stamp compliance for cancelled certificates
  9. Independent dividend agent
  10. Impress dividend account
  11. Periodic reconciliation of dividend account
  12. Adequacy of stockholders' ledger
  13. Review of stock restrictions and provision
  14. Valuation procedures for stock issuance
  15. Other paid-in capital entries
  16. Other retained earnings entries

### 23.5.3 Forensic Auditing

Auditing for fraud is known as forensic auditing. The accounting profession has not developed forensic auditing to the degree that it should. Public accountants, i.e., certified public accountants, audit for financial statement presentation. Internal auditors examine for compliance with company policies and procedures. The Government Accounting Office

audits for compliance with government programs. The Internal Revenue Service audits primarily for compliance with federal tax laws. However, the IRS has specialized auditors who do forensic auditing. Their numbers are few and their emphasis is tax evasion; recently, the IRS has expanded into money laundering.

#### **23.5.4 Forensic Audit Phases**

There are four phases of forensic auditing:

1. Recognition and planning stage
2. Evidence collection
3. Evidence evaluation
4. Communication of results

##### ***23.5.4.1 Recognition and Planning Stage***

There must be some prediction — some reason to believe — that fraud exists before a fraud examiner conducts an audit. The problem must be defined. All possible explanations should be explored. Also, the examination should be planned in terms of staff, methods, place, and needs.

##### ***23.5.4.2 Evidence Collection***

The second phase of forensic auditing is evidence collection. The purpose is to determine whether initial evidence of fraud is misleading and if more procedures are needed to resolve the fraud.

##### ***23.5.4.3 Evidence Evaluation***

This phase determines what type of legal action should be taken, if any. Some cases will only warrant civil action, which is obtaining restitution. In other cases, criminal action may be warranted. In civil cases, the degree of evidence must be “clear and convincing.” In criminal cases, the evidence must prove “beyond a reasonable doubt.” When using an indirect method, i.e., net worth, expenditure, or bank deposit method, the evidence must prove “with reasonable certainty.” This stage requires the cooperation of management, legal counsel, internal audit, and corporate security. If the evidence is strong enough to stand up in court, then strategy should be planned and followed.

##### ***23.5.4.4 Communication***

An audit report should be prepared and presented to management. This report should encompass a good description of the fraud, who perpetrated it, and both documentary and testimony evidence.

### **23.6 Evidence-Gathering Techniques**

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There are various evidence-gathering techniques that can be used. In most cases, a combination of various evidence-gathering techniques is required to support a case. The elements of fraud are the theft act, concealment, and conversion. The evidence-gathering techniques are designed to uncover these fraud elements.

1. **Interviewing.** Interviewing is an important evidence-gathering technique. It helps obtain information, which establishes elements of a crime, provides additional leads, gets cooperation of witnesses and victims, and obtains the economic motives behind a perpetrator.
2. **Vulnerability and internal control charts.** Vulnerability and internal control charts help examiners determine the best probabilities where fraud is likely to occur.
3. **Document examination.** This technique uncovers concealment efforts of perpetrators by manipulating source documents.
4. **Employee searches.** This technique involves examining an employee's desk, locker, lunch box, etc. It is important not to violate a person's constitutional rights of illegal searches. Searches are legal if conducted in a proper manner and with adequate notice. If obtained illegally, evidence can be inadmissible in court.
5. **Invigilation.** This technique involves the close supervision of suspects during an examination period. It can be effective in identifying who commits the fraud and where the fraud is occurring. It is particularly useful in catching fraud that is committed by independent suppliers, night watchmen, warehouse supervisors, purchasing agents, and cashiers. Its drawbacks are high cost and it could cause low employee morale.
6. **Observation.** Observation is watching, looking, spying, or snooping to gather evidence. These observations are recorded on various kinds of media. This can show how the fraud is being committed.
7. **Undercover.** Undercover operations require an agent or informant. This technique should be used for major criminal acts, i.e., organized crime activities. It is important that the operation remain secret. It is also very dangerous for the undercover agent.
8. **Specific item.** Specific item evidence is locating and identifying specific documents that show fraud has occurred. This can be with one or more documents, i.e., altered contract or many cancelled checks.

## 23.7 Fraud Indicators

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There are clues that indicate fraud exists. These symptoms do not guarantee that fraud exists, but can be warning signs that fraud can or has occurred. There are environmental and personal symptoms called red flags.

### 23.7.1 Environmental Symptoms

The most common environmental symptoms that encourage fraud are:

1. **Loose internal controls.** If internal controls are not enforced, then the opportunity of fraud occurring is great. Fraud occurs more often when internal controls are ignored.
2. **Poor management philosophy.** If top management is dishonest, then dishonesty will flow down to employees. When autocratic management sets budgets that are impossible to attain, lower managers will have to cheat, fail, or quit. If management does not prosecute fraud offenders, even if small offenses, it sends a signal that the company does not deal harshly with criminals.

3. **Poor financial position.** If a company has poor cash flow, then fraud is more likely to occur. Employees are more likely to take advantage of a company when they feel insecure about their jobs or the company's existence.
4. **Low employee morale.** When employee morale is low, they lack loyalty and feel wronged. Low employee morale can be the result of personal problems or work related. Perceived inequities at the workplace can lead to decreased employee loyalty. Some identified reasons for employee fraud to "correct" injustices are:
  - a. Being passed over for a raise
  - b. Being passed over for a promotion
  - c. Being subjected to disciplinary action
  - d. Feeling that pay is inadequate
  - e. Favoritism to other employees
  - f. Resentment toward superiors
  - g. Frustration with job
  - h. Boredom
5. **Ethics confusion.** If a company does not have an ethics code, then this could lead to employee confusion. What is the line between a gift and a kickback? What is a company secret? A corporate code of conduct and policy statements should be promulgated. These policies should address what types of gifts are acceptable, access to certain operating units, and security policies.
6. **Background checks.** The lack of a background check or the failure to exercise due care when hiring new employees can be costly. Proper screening has many benefits:
  - a. More honest employees
  - b. Acts as a deterrent to employee dishonesty
  - c. Protects innocent employees from false accusations
  - d. Eliminates problem employees such as substance abusers, serial thieves, etc.
  - e. Eliminates poor security risks
  - f. Permits honest employees to work in harmonySome common problems that employers encounter are:
  - a. Previous arrests
  - b. Unstable work record
  - c. Fired from previous job
  - d. Employee theft
  - e. Mental instability
  - f. Drug/substance abuse
  - g. Personal/domestic problems
  - h. Health defects
  - i. Bad tempers
7. **Lack of employee support programs.** Job stress or personal problems can lead to fraud. An organization can help employees deal with job or personal problems. First, the company can establish employee assistance programs that confidentially counsel employees about their problems. Second, the organization can have an open-door policy within the organization. Managers can encourage good employee relationships. If managers are alert, they can identify danger signs and be available to assist.
8. **General conditions.** Other symptoms that promote fraud are near-term mergers or acquisitions, regulatory problems, rapid turnover of employees, too much trust in key employees, and lack of physical security.



### 23.7.2 Personal Symptoms

There are three specific symptoms of possible employee fraud:

1. **Personal financial factor.** Employees are likely to commit fraud when they have serious financial problems. They are more likely to commit fraud as a solution to their problem. The symptoms exhibited are employees taking expensive vacations; purchasing expensive vehicles, boats, cottages, cabins, and personal items; and bragging about their money.
2. **Personal habits.** Employee habits can induce fraud. Drug abuse, gambling, speculative investments, and maintaining a second household because of divorce can be a strong indication of potential fraud.
3. **Personal feelings.** Employee feelings are another symptom for committing fraud. Employees with high expectations, perceptions of being mistreated by management, frustrations with the job, or poor family or community relationships are likely candidates.

## 23.8 Types of Fraud

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### 23.8.1 Kiting

Check kiting is a form of embezzlement. It is a type of fraud that embezzles a bank out of funds. It involves two or more bank accounts at two or more different banks. The objective is to cover up a check or withdrawal that is not recorded on the books by writing checks from each bank account to another bank account. When the interbank checks clear, one bank loses out by the checks that were cashed or withdrawn. A bank transfer schedule is effective in detecting this scheme. A four-columns plus bank reconciliation would clearly uncover this scheme.

### 23.8.2 Lapping

Lapping is an embezzlement scheme in which cash collections from customers are stolen. To keep the embezzlement from being discovered, the embezzler corrects the customers' accounts within a few days by posting other customer cash receipts to the accounts for which the proceeds have been embezzled. Lapping occurs most frequently when one individual has both record-keeping responsibility and custody of cash. Lapping will increase the average age of receivables and decrease turnover. The examiner should watch for posting of cash after an unusually long time. Also, the examiner should compare deposit slips from the bank with names, dates, and amounts on remittance advices. The examiner should investigate customer complaints.

### 23.8.3 Ghost Employees

Funds are channeled to fictitious or former employees, known as ghost employees, through phony salary payments. This should be examined closely when union members are employed. Organized crime figures use ghost employees to channel funds. A common practice is to employ people who do not work or even show up to the job. In such cases, the examiner should compare payroll files with personnel files, employment applications,

tax statements, insurance and union deductions, and payroll checks. Also, the examiner should compare travel and expense vouchers to employment records and tax records.

### 23.8.4 Illegal Activities

Organized crime groups, as well as individuals, operate illegal activities. These illegal activities encompass the following:

1. **Arson.** This crime can have one of several motives: one is nonfinancial and the other is for economic gain. An example of a nonfinancial motive would be a disgruntled employee. Most financial motives in arson are related to insurance claims or the elimination of competition. In case of insurance claims, the financial condition of the enterprise should be examined thoroughly to determine profitability. A losing enterprise will try to bail out by committing arson and file insurance claims. In the case of elimination of competition, the competitor will commit arson to cause financial hardship to the victim so it may not be able to recover or to disrupt the victim's operations.
2. **Counterfeiting.** Counterfeiting involves not only money, but also food stamps, coupons, bonds, stocks, credit cards, and anything else of value that can be duplicated. A key element of examining counterfeiters is obtaining the records from suppliers and vendors.
3. **Frauds.** Men or women commit various kinds of fraud. Individuals, corporations, and partnerships commit it. There are many kinds of frauds. Fraud involves any means that human ingenuity can devise to take advantage of another by false suggestion or suppression of the truth. It encompasses any surprises, tricks, cunning, or way to cheat, steal, or take anything of value from an individual or business. The victims of such crimes have the documents and can testify in such cases.
4. **Gambling.** Organized crime groups, as well as some individuals, get involved in gambling activities. The most common are sports bookmaking, bingo, racetracks, casinos, and bolito (lottery). Most states have strong laws against gambling activities. In some states, gambling is legal but is highly regulated. Some states even have their own gambling, e.g., lotteries. In Chapter 16, gambling is addressed in more detail.
5. **Illegal alcohol.** Unlicensed production, sale, and distribution of alcohol are illegal in most states, as well as federally. The primary reason for the illegal sale of alcohol is the lack of collection of sales or excise tax. Another reason is that the alcohol may be contaminated, which could cause death if someone drinks it. This was a popular method of getting extra funds by various individuals. However, since the introduction of drugs and marijuana into our society, alcohol has become less of a concern to local or federal law enforcement. The key element is obtaining financial data on ingredients from suppliers and vendors.
6. **Loan-sharking.** Loan-sharking is the illegal activity of loaning money to people at exorbitant rates of interest. Interest rates are normally 2 to 5% per week or day. The loan shark requires a business front from which to conceal his illegal activities. This can be any kind of business. In some cases, the business was acquired on a defaulted loan or the loan shark has taken over for a legitimate owner as a front. Some of the signs of loan-sharking are:

- a. The collateral for the loan is not commensurate with the amount loaned.
  - b. The lender requires no references or financial statements.
  - c. The effective rate of interest is beyond legal limits.
  - d. The lender has no connection with any legal lending institution.
  - e. The borrower has a history of extensive gambling.
  - f. The borrower is living beyond his means.
  - g. There are excessive losses in the stock or bond market by the borrower.
  - h. Finder's fees are paid for securing financing.
  - i. There are high rates of theft in the business.
  - j. Endorsements on checks indicate payments to people with no legitimate connection to the business.
  - k. Money received is in the form of cash rather than by check.
  - l. The paperwork or loan documents are skimpy or nonexistent.
7. **Narcotics.** Narcotics involves the sale of any type of illegal drug. This encompasses drugs such as heroin, cocaine, marijuana, and various synthetic or pharmaceutical drugs, whether legal or illegal. The fraud examiner must focus on the lifestyle of the drug trafficker.
8. **Prostitution.** This crime involves the sale of sexual intercourse for pay. Pimps are individuals who control prostitutes as to their "johns" and the amount that they can earn. Pimps usually get a big cut of the profits or gross receipts, leaving the woman or man with little income. The prostitutes usually have to be totally dependent on the boss — pimp. One fraud examiner determined income by counting the towels being used. Otherwise, the fraud examiner must focus on the lifestyle.
9. **Protection rackets.** This usually involves organized crime groups. Protection rackets encompass the charging of businesses for protection. This is like insurance, except that no protection is guaranteed. There are no benefits paid out like insurance. This is more prevalent in oriental communities today than anywhere else. The fraud examiner will have to rely on the victims, who, because of retaliation, may not cooperate.
10. **Smuggling.** This activity involves the secret transportation of illegal goods either into or out of the country, or both. Profits are made by the subsequent selling of those goods. The smuggler has no cost of sales or purchases. If invoices are provided, they will be false documents. If the supplier provides invoices, then he or she is part of the conspiracy and must also be examined.
11. **Stolen property.** Organized crime groups, as well as individuals, either steal or buy and then sell stolen property. This is called fencing. Investigators look for the following signs of fencing:
- a. The costs of purchases are unusually low.
  - b. Payments are made in cash.
  - c. There are no invoices, bills of lading, or shipping receipts.
  - d. The supplier cannot be identified.
  - e. The business owners or sellers of the merchandise have no knowledge about the products they are selling.
  - f. The business has not been in existence very long.

### 23.8.5 Legal Activities

People involved in illegal activities must somehow launder their profits through legitimate businesses. Businesses that are most susceptible to laundering profits are:

1. **Auto agencies.** These are used as fronts for stolen vehicles.
2. **Factoring.** Criminals use factors in diverting corporate skimming from various businesses into the accounts receivable as sales or payments of accounts receivable from various businesses.
3. **Food products.** Criminals use food stores as a way to launder money from illegal activities, as well as skimming sales receipts.
4. **Garment manufacturing.** Organized crime groups use this industry to sell off-brands for well-known brands of clothing. This industry is also susceptible to labor racketeering, kickbacks, ghost employees, and extortion.
5. **Juke boxes and video machines.** These are used by criminals to obtain income without reporting the income to federal and state tax authorities. Also, they are excellent vehicles for money laundering.
6. **Liquor distribution.** This involves stealing and selling liquor at discounts to liquor stores and bars. The profits, of course, are not reported to federal and state tax authorities.
7. **Nightclubs.** Since these are cash businesses, they lend themselves to skimming. Organized crime groups use nightclubs to operate prostitution rings and extort funds from the dancers.
8. **Trade associations.** These involve labor racketeering. They exploit funds from labor unions, especially pension funds.
9. **Trucking.** Organized crime groups use trucking to extort higher fees for transportation of goods.
10. **Vending machines.** Like juke boxes and video machines, vending machines are used to obtain income without reporting it to the tax authorities. However, profits can be more readily determined by use of the gross profit method, as discussed in Chapter 14.
11. **Waste collections.** Organized crime groups use this industry to obtain funds without paying for dumping fees and violate environmental laws. Their customers are reluctant to cooperate since they are violating environmental laws.
12. **Construction.** Organized crime groups use this industry to extort funds from contractors. They do this in controlling labor and using ghost employees on the contractor payroll.
13. **Hotels and motels.** This industry lends itself to skimming as well as money laundering.
14. **Real estate.** This industry is used primarily for laundering money from illegal activities as an investment for criminals. However, it is also used for selling property above market values.
15. **Securities.** Criminals use this industry as a front for counterfeit securities, as well as money laundering.
16. **Mortgages.** Criminals use these as a means of laundering money. They usually charge higher rates in order to later repossess the valuable real estate at bargain prices.

17. **Entertainment.** Organized crime uses the entertainment industry to skim profits and steal funds from entertainers by not reporting the actual gross receipts of which entertainers get a percentage. Also, they use this to bust out, which leaves owners holding the bag.
18. **Credit cards.** Criminals use credit cards to obtain merchandise that is later fenced. The credit cards are usually stolen from customers or their numbers are used to make purchases. Some criminal groups steal the cards from the mail before the customers are able to receive them.
19. **Insurance.** Criminals sell insurance policies for companies that do not exist. Some criminals set up their own insurance companies with the intent of not paying claims.
20. **Labor.** Organized criminal groups exploit various labor groups. They do this by embezzling labor union funds. The major target by criminal groups is labor union pension funds since they consist of large amounts that need to be invested so that funds are available for the future benefits of its members.
21. **Banking.** Criminals like to defraud banks by either obtaining bad loans or check kiting. Drug traffickers like to use banks for laundering their illegal profits.

### 23.8.6 Intelligence

Before a fraud examiner commences any examination, he should obtain as much information as possible about the type of fraud that is being committed. This intelligence will help the fraud examiner determine where he should focus his investigation. If the fraud examiner has intelligence that a particular type of fraud is being committed, then he can focus his efforts where that type of fraud is being committed. This intelligence can save time and money for the client, since the time of investigation and examination will be cut to a minimum. Companies with internal and/or external auditors should use them to develop as much evidence about the fraud scheme as possible before a fraud examiner is retained. The fraud examiner is interested in uncovering fraud and not issuing an opinion as to a company's financial condition.

## 23.9 Summary

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The audit program is only a guide for the fraud examiner. It helps focus the examiner on where the fraud is being committed. However, the examiner must first rely on intelligence before he can start gathering evidence. If no intelligence is available, then the examiner must search for red flags. Various types of analysis, financial and nonfinancial, can help identify those red flags. The biggest problem for fraud examiners is determining the effectiveness of internal controls. On paper, internal controls of a business look good, but when they are observed close up, they are deficient or nonexistent.



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## 24.1 Introduction

Forfeitures and seizures by governmental entities have been in existence since the American Revolution. England and the American Colonies have used forfeitures to enforce Customs and revenue laws. They are still used today in England, Canada, Australia, New Zealand, and the U.S. Forfeitures were used as a means of punishment for violation of Customs and revenue laws. However, during this century, forfeiture and seizure laws have been expanded to encompass most crimes. They have been aimed at drug traffickers and white-collar criminals in recent years. Forfeitures have been asserted in both civil and criminal cases. Today, forfeitures and seizures are used to deprive criminals of their illegal gains.

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## 24.2 Federal Laws

The U.S. government has many forfeiture laws on the books. The following is a partial list of those forfeiture laws that are commonly used by federal prosecutors:

1. Title 18: Criminal Code
  - Section 492: Counterfeiting
  - Section 545: Smuggling
  - Section 981: Civil “White Collar” Transactions
  - Section 982: Criminal “White Collar” Transactions
  - Section 1467: Obscene Materials
  - Section 1956: Money Laundering for Monetary Instruments
  - Section 1957: Money Laundering for Property
  - Section 1963: Racketeering — Criminal
  - Section 1964: Racketeering — Civil
  - Section 2339C: Financing Terrorism
2. Title 19: Customs
  - Section 1595(a): Conveyances and Items Used to Facilitate Illegally Introduced Items

3. Title 21: Drugs and Controlled Substances
  - Section 848: Continuing Criminal Enterprises
  - Section 853: Drug Felonies — Criminal
  - Section 881: Controlled Substances — Civil
4. Title 26: Taxation
  - Section 7301: Property Subject to Tax
  - Section 7302: Property Used in Violation of Internal Revenue Laws
  - Section 7303: Other Property Subject to Forfeiture
5. Title 31: Money and Currency
  - Section 5111: Coin Melting
  - Section 5317: Unreported Monetary Instruments
  - Section 5321: Civil Penalties
  - Section 5322: Criminal Penalties
6. Title 49: Transportation
  - Section 782: Contraband Seizures
  - Section 1474: Civil Aircraft

### 24.3 Property

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All kinds of property are subject to seizure and forfeiture. This includes all real and personal property, tangible and intangible property. Many states also have forfeiture laws on their books. State forfeiture laws are usually patterned after the federal statutes with some modifications. However, both federal and state forfeiture laws subject forfeitable property in the following categories:

1. **Illegal goods.** Illegal goods consist of things like drugs, cigarettes, liquor, and other personal and intangible property that has been specifically outlawed by federal or state statutes. These assets can be seized and forfeited at the point of discovery. Contraband property is usually destroyed after criminal trials of defendants.
2. **Direct ties.** Legal property, whether personal, real, or intangible, can be seized and forfeited if it can be shown that it was obtained from the proceeds of illegal activities. An example of this is when a drug trafficker purchases a vehicle (legal property) with the profits from the sale of drugs (illegal income). Also, the property used in the manufacture, distribution, and sale of contraband is also subject to seizure and forfeiture. If an aircraft was discovered with illegal contraband, then the aircraft is subject to immediate seizure and forfeiture. The connection — nexus — between the illegal activity and the assets is the key element in direct seizures and forfeitures.
3. **Indirect ties.** Illegal profits are sometimes mingled with legal sources, which make them impossible to distinguish. This is particularly true with organized crime groups, which launder their illegal gains in legitimate sources. However, Congress has passed laws during this century to overcome this obstacle. Al Capone was the first subject convicted using the Internal Revenue Code. In this case, the Internal Revenue Service used the net worth method of determining unreported taxable

income. It has been expanded, particularly under the Racketeer Influenced and Corrupt Organization (RICO) and Continuing Criminal Enterprise (CCE) Acts, to use the net worth and expenditure methods in determining illegal gains. Once illegal gains have been determined, then the forfeiture is based on the amount of the gain.

## 24.4 Civil Forfeiture

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Civil forfeitures are legal actions against property. These are called *in rem* actions since they are made against property and not individuals or corporations. The burden of proof is not as great as in criminal actions. Civil actions only require the government to show “clear and convincing” evidence. The rules of evidence are more relaxed. Hearsay evidence can be introduced. Opinions can be expressed. However, unauthorized searches and wire-taps are not admissible. Civil forfeiture actions present a dilemma to subjects of criminal actions. If the civil actions take place before criminal proceedings, then the property owner can be compelled to produce evidence, which can later be used in criminal proceedings. Also, civil forfeiture actions can be instituted, while criminal actions may never be made. In addition, the property owner must establish control, in addition to just having good title. The government is not required to show a direct relationship between the property seized and a specific drug transaction.

## 24.5 Criminal Forfeiture

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Criminal forfeitures are made against criminals who have been convicted of crimes. Criminal forfeitures are called *in personam* since they are directed against a person. The rules of evidence are strictly adhered to in these cases. Reasonable doubt or “with reasonable certainty,” when the net worth and expenditure methods are used, must be established in criminal cases. All evidence introduced in criminal proceedings can be used in any civil proceedings.

1. **Direct ties.** Forfeitures and seizures can be made based on direct evidence that illegal gains were directly invested in identified assets. Assets that are used in the transportation, storage, purchase, and sale can be seized and forfeited. Any assets that are used in the promotion of any illegal contraband can be seized and forfeited.
2. **Indirect ties.** In criminal proceedings, assets can be forfeited whether or not used or acquired from illegal gains. The RICO and CCE statutes provide for forfeitures based on twice the illegal gains. This provides for forfeiture of legally obtained assets as well as assets acquired from illegal activities. The RICO net worth and expenditure methods are used to determine the illegal gains.

## 24.6 Innocent Owner

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The federal forfeiture laws make provisions for seizure and forfeiture of property of innocent owners. The burden of proof rests on the innocent owner that he or she:



1. Had no knowledge of the illegal use of the property
2. Was not a party to the illegal activity
3. Would have prevented the use of the property in the illegal activity, if known

## 24.7 Federal Guidelines

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In 1987, the U.S. Department of Justice issued guidelines on seized and forfeited property. These guidelines were formulated because of the Comprehensive Crime Control Act of 1984 and the Anti-Drug Abuse Act of 1986, which address the disposition of forfeited property. These guidelines were promulgated to:

1. Promote cooperative law enforcement efforts in drug trafficking and other investigations
2. Ensure equitable transfer of forfeited property to the appropriate state or local law enforcement agency

## 24.8 Use and Transfer of Forfeited Property

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The U.S. attorney general has the authority to retain any civilly or criminally forfeited property or to transfer the property to other federal, state, or local law enforcement agencies. In order for the attorney general to transfer forfeited property to any federal, state, or local law enforcement agency, the law enforcement agency must have directly participated in the acts that led to the seizure or forfeiture. The attorney general or his designee on an equitable basis will determine the transfer of forfeited property. The basis will generally be on the relative contribution of the participating agencies to the investigation leading to the property's seizure and forfeiture. Property that is transferred to federal, state, or local agencies is to be used to increase resources for that agency. It is not to be used for salaries and regular operating expenses. If the federal forfeiture action is concluded successfully, and the property is not placed into official use or transferred to a federal, state, or local agency, it will be sold and the net proceeds of the sale will be placed in the Assets Forfeiture Fund. Forfeited cash will also be placed in the Assets Forfeiture Fund. If real or tangible property is transferred to federal, state, or local agencies, the recipient must pay the liens and mortgages on the forfeited property, as well as any expenses in transferring the property.

## 24.9 Assets Forfeiture Fund

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The attorney general has made the U.S. Marshal Service responsible for administering the Assets Forfeiture Fund. There are two categories of reimbursements from the fund:

1. **Asset-specific expenses.** Asset-specific expenses are reimbursements for the management expenses. These take priority over program-related expenses. Asset-specific expenses are:
  - a. Expenses incurred for safeguarding, maintenance, or disposal of seized or forfeited property whether by federal, state, or local agencies

- b. Payments on orders of mitigation or remission
  - c. Payments of valid liens and mortgages pursuant to court order
  - d. Equitable transfer payments to state or local law enforcement agencies
  - e. Payments for contract service relating to the processing of and accounting for seizures and forfeitures
  - f. Payments for storage, protection, and destruction of controlled substances
  - g. Case-specific expenses relating to travel and subsistence, cost of depositions, messenger services, expert witnesses, and other direct costs
2. **Program-related expenses.** The following are program-related expenses:
- a. Expenses for the purchase or lease of computer equipment, and related services, at least 90% of whose use will be dedicated to seizure- or forfeiture-related record keeping
  - b. Payments to authorized investigative agents for the purchase of controlled substances
  - c. Expenses incurred to equip any conveyance
  - d. Payment of awards in recognition of information or assistance given to an investigator
  - e. Expenses for training that relates to the execution of seizure or forfeiture responsibilities
  - f. Expenses incurred for printing training material

### 24.9.1 Liens and Mortgages

Liens and mortgages can only be paid pursuant to an order of remission or mitigation or an order of the court. Otherwise, such amounts shall be paid from the proceeds of sale. The payment of liens and mortgages can be made if they are beneficial to the government. Two circumstances exist for this:

1. Payment prior to the sale will improve the government's ability to convey title.
2. The property is to be placed into official use by the government.

Payments to unsecured creditors of seized and forfeited property are generally not allowed. However, in the case of a business, claims incurred within 30 days of the seizure can be paid. In addition, payments can be made for reasonable salaries and benefits of employees not believed to have been involved in the unlawful activities giving rise to the forfeiture, and not having any ownership interest in the firm. Third-party contractors of goods and services can be paid if they are necessary to carry on the business activity of the firm in a regular manner. Utilities also can be paid.

### 24.10 Internal Revenue Service Rewards

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The Internal Revenue Service has provision under Title 26 of the U.S. Code (USC) to reward both informants and state and local law enforcement for providing information on violation of federal tax laws. Employees of the Treasury Department and individuals who are employed by other federal, state, or local law enforcement agencies are not eligible to receive any awards. Informants can have their identities remain anonymous. Rewards are divided into two categories:

1. **Informants.** Under Section 7623, Internal Revenue Code, and related regulations, an informant can receive up to 10% of the amount of taxes, penalties, and fines that are recovered. However, this 10% ceiling does not bind the IRS to fix the amount with regard to any percentage or formula. Although the law indicates that an informant may be rewarded for supplying information to the IRS, it does not bind the IRS to reward all informants. The informant must file Form 211 with either the director of the district in which he or she resides or the commissioner of the Internal Revenue Service in Washington, D.C.
2. **State and local law enforcement.** Under Section 7624, Internal Revenue Code, and related regulations, state and local law enforcement agencies can get reimbursed by the Internal Revenue Service for costs incurred, i.e., salaries, overtime pay, per diem, and similar reasonable expenses, not to exceed 10% of the sum recovered. This is a cost reimbursement program and not a reward program. Therefore, they must meet certain criteria as follows:
  - a. The federal taxes imposed must be related to illegal drug trafficking or related money laundering activities.
  - b. No other reimbursement has been made under federal or state forfeiture programs or state revenue laws.
  - c. The Internal Revenue Service must not have the individual already under investigation.
  - d. The taxes, penalties, and fines must aggregate more than \$50,000 in order to be eligible for reimbursement. This is called the *de minimis* rule.
  - e. Reimbursement of expenses cannot exceed 10% of the total taxes, penalties, and fines collected.

## 24.11 Summary

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Fraud examiners get involved in forfeitures; therefore, they should understand the legal reasons for the forfeitures and seizures. In many criminal cases, the fraud examiner's work product either directly or indirectly involves forfeitures. When an examiner determines the income from illegal activities, it is this figure that can be used to determine the forfeiture, whether a civil or criminal case. One of the primary purposes of forfeitures is to take away the profits gained from illegal activities.



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## 25.1 Introduction

An important element that the fraud examiner should know is how the judicial system is organized and how it operates. When a fraud examiner uncovers fraud, he or she must know how to get a case prosecuted. To do this, the fraud examiner must know to whom the crime must be reported, what procedures must be followed, and what the policies are. The fraud examiner should be aware of how the case progresses through the legal system to its ultimate conclusion. This chapter gives the fraud examiner an overview of the judicial system in the U.S.

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## 25.2 History

The law as we know it is the outgrowth of the legal systems of England and Rome. The English jurist Blackstone defined law as “a rule of civil conduct prescribed by the supreme power of the state, commanding what is right and prohibiting what is wrong.” The Roman orator Cicero stated, “The State without law would be like the human body without a mind.” Legal systems, which are based on Roman codes and customs, are commonly referred to as civil law jurisdictions, while those derived from Britain are known as common-law jurisdictions. The civil law is followed in Europe and South and Central America; the common law is followed in the U.S., Canada, and Australia, with the exceptions of Louisiana and Quebec, whose legal codes are based on civil law. In addition to the civil and common laws, canon law has made an imprint upon our jurisprudence system by the Roman Catholic and Anglican Churches. The law merchant, a body of rules governing medieval business affairs of the mercantile class, has also influenced modern jurisprudence.

During the early part of the fifth century B.C., the lower classes in Rome, unequally treated in the application of customs prevailing at the time, became increasingly discontented. As a result of their protests, in 449 B.C. the so-called Twelve Tables were promulgated, codifying the customs and making them applicable to all Romans. These tables remained in effect for 400 years.

By the opening of the Christian era, Rome had become a vast superstate, ruled by an emperor. During the ensuing centuries, economic and social conditions changed drastically, causing many imperial decrees and administrative orders to be added to the body of

law. By the sixth century A.D., it was almost impossible to determine the law governing any particular controversy. The Byzantine emperor Justinian began the task of clarifying and organizing this mass of Roman law. The Code of Justinian was published in 528–534 A.D., together with the Digest (excerpts from the writings of Roman jurists), the Institutes (a short manual for law students and jurists), and the Novels (a new constitution). The Code of Justinian established a legal and legislative reform that lasted until the fall of the eastern Roman Empire in the 14th century.

Interest in the civil law system was revived in medieval Italy during the Christian Renaissance period. While the Church originally was hostile to Roman law, probably because Justinian's code emphasized the secular against the clerical authority as the supreme power of the state, it soon encouraged the study of civil law and reemphasized the significance and benefits of a formal system of jurisprudence. The legal profession was then created and training in Latin and Roman law was required of all law students, who were later employed as administrators by members of royalty.

The English common law, upon which most all of our American law is founded, came into existence after the Norman Conquest in 1066 A.D. Prior to that there was no law of England, and feudal law, with its system of manorial courts, was just in the process of creation. The ruling Anglo-Saxons governed various parts of England according to local custom, thereby eliminating any possibility of a uniform system of law. The clergy were separately governed by canon law, administered in the ecclesiastical courts (Courts Christian). Before the Norman Conquest, it was not unusual for the bishop to preside in the secular courts. After the conquest, William I introduced many administrative reforms, strengthened the feudal courts, and made a real effort to separate the ecclesiastical from the secular jurisdictions.

The common law actually began under Henry I, after 1100 A.D. It developed into a system of separate royal courts, such as the Courts of the Exchequer, each court developing its own substantive and procedural law. The law was referred to then as the King's Justice and was administered by justices appointed by the ruling monarch. In nearly all cases, these justices were members of the ruling class. In most cases, these justices were members of the clergy who exerted royal jurisdiction by a system of writs. These writs were authorizations or directions to the sheriff to summon a litigant to appear before the court for the purpose of answering a claim of a royal officer, a member of the nobility, or a wealthy patron. General considerations of fairness and equity, according to prevailing views of society, were supposed to be the foundation of legal decisions by the justices. Roman legal scholars had boasted of their enlightened maxim: *Salus populi suprema lex* (the people's welfare is the supreme law). In England at this time, the Norman trial by battle or ordeal was a frequent means of determining legal rights in both civil and criminal actions.

Writs in the king's courts were not readily available to persons of ordinary means. They were extremely costly and limited to certain types of cases. This gave rise to the establishment of chancery courts and the development of a body of law known as equity law. The rapidly growing number of writs eventually made it possible to collect them and put them into law books, which later became known as registers. The registers were the first formal collation of legal precedents. By 1297 A.D. and the appearance of the Magna Carta, the law of the king's court had acquired the special name of common law. Publications of the king's courts, written by legal scholars, gave a yearly record of all cases argued before the courts. These yearbooks contained the common law and laid the foundation

for this system's reliance on precedent. Reliance on precedent is the most significant difference between the common law and the civil law.

The English colonists in America, despite the fact that they sought to free themselves of the British yoke, brought with them the prevailing English legal system. The common law of England found its way into many local ordinances and state constitutions. Most states have enacted many statutory reforms to replace the outmoded and narrow common-law concepts, to furnish a better basis for the simpler administration of the law and justice in our courts according to the needs of our growing and ever-changing society. The Anglo-American systems of jurisprudence, while relying upon precedent as a guide, are notable for their ability to accept new ideas and principles by which equitable and speedy justice can be attained.

### **25.3 Local Law Enforcement**

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In the U.S., law enforcement authorities have been decentralized down to the local communities. Local communities consist of municipalities that are cities or towns having their own incorporated government. These incorporated municipalities are organized into departments, which have a police department. The police department is under the control of local mayors and city commissioners. The city commission passes ordinances, which the police department is required to enforce. Also, the police departments are empowered to enforce federal and state laws. The police department operates with almost complete autonomy within its jurisdiction. The police have a great amount of discretion as to the laws that they will enforce and on whom they will impose the laws and ordinances. However, they do not and cannot enforce laws, including federal and state, outside their respective jurisdictions. On occasions, local police work with state or federal law enforcement agencies on task forces. While on these task forces, they are granted temporary authority outside their jurisdiction.

States are divided into various counties, which have their own county governments. These county governments have a law enforcement department, usually called the sheriff's office or department. Like the police department, the sheriff's department is under the control of the county commissioners and mayors. It enforces county ordinances and state and federal laws and has autonomy within its jurisdiction. In addition, it can enforce the city ordinances that are located within its county. Like the police, it has discretion regarding what laws and ordinances it will enforce and on whom it will enforce them. Sheriff's departments have jurisdiction within the municipalities within their county. However, sheriff's departments will usually not interfere with the police in their jurisdiction.

### **25.4 Officers and Deputies**

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Police officers and deputy sheriffs normally come from middle-class families with close family ties. Most people become police officers because they are attracted to a civil service job. Most recruits have only high school diplomas. In recent years, however, many local law enforcement agencies are requiring applicants to have associate's and bachelor's degrees. Some police departments recruit from the military because of their maturity, discipline, and training of such applicants. Since police carry weapons, wear uniforms, and

are instructed into a military type of organization, police departments are sometimes viewed as paramilitary organizations. Many large police and sheriff's departments have special weapons and tactics (SWAT) teams. These SWAT teams were formed to combat the more violent members of society. Members of SWAT teams are usually former military people since these tactics come from military operations.

The local police have greater contact with members of the community. As a result, they see and come into closer contact with criminals than anyone else. They see criminal acts or the aftermath firsthand. Horrible accidents and violent crime scenes may cause police to become dispassionate. They could view the court system as too lenient against the hardened criminal. Some police feel the bureaucracy within their department restricts them from doing their jobs. Even though corruption within a department may involve only a small number or percentage, it causes polarization of the community, those supportive vs. those critical. Some police officers constantly see criminals with high living standards, far above their own. This, in turn, causes some police officers to cross over to the criminals' side and become corrupt. Those police officers who see corruption in the local political structure may become corrupt along with it. If they may try to fight it, then they lose any promotion opportunities or are transferred to menial assignments.

## **25.5 State Law Enforcement**

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All states have their respective law enforcement agencies, which are responsible for enforcing state laws. The state, unlike counties and municipalities, has more than one law enforcement agency. The states structure their agencies into specialty areas. The state police enforce traffic laws on the highways and other crimes that cross county lines. Other departments within the state have agencies that have law enforcement powers. Revenue departments have agents that go after tax evaders. The Insurance Department has agents that investigate and prosecute fraudulent claims and insurance companies. Departments of Business and Professional Regulations investigate and prosecute crimes relating to various businesses and professions. Business crimes might include improper liquor, cigarette, land, banking, and restaurant operations. Professional crimes would include investigating and prosecuting crimes relating to professional groups, i.e., medical, law, engineering, accounting, nursing, pharmacy, etc.

States generally require higher standards and education for their agents. This is mostly because the crimes they have to investigate require greater skills. A normal high school graduate would not have the skills to investigate such crimes as medical malpractice, securities and banking fraud, racketeering, criminal enterprises, insurance, and a host of others.

## **25.6 Federal Law Enforcement**

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The U.S. government has law enforcement agencies within practically every department. Since Americans do not want a national police force, like some countries, the federal government has established law enforcement agencies within each department. Each law enforcement agency is only responsible for enforcing the laws and regulations for that department. Americans have been reluctant to have a national police force since it would

pose the threat of quasi-military power. Even the military in the U.S. comes under civilian control.

The U.S. Department of Justice is the primary department for prosecuting criminals. Within the Justice Department, there are many law enforcement agencies. The principal law enforcement agencies are as follows:

1. **Federal Bureau of Investigation.** Responsible for investigating most federal crimes. It also investigates criminals who cross state lines to avoid prosecution.
2. **U.S. Marshal Service.** Responsible for courtroom security and going after criminals who flee from prosecution. It produces prisoners for trials and is responsible for service of process.
3. **Border Patrol.** Responsible for patrolling U.S. borders and investigating alien smuggling and apprehending illegal aliens.
4. **Drug Enforcement Agency.** Responsible for investigating and apprehending drug traffickers and other drug violations.

The U.S. Treasury Department has many law enforcement agencies:

1. **Secret Service.** Protects the president and other federal and foreign officials. It investigates counterfeiting of currency and other government obligations and credit card fraud.
2. **U.S. Customs Service.** Enforces Customs laws, duties, and products entering or leaving the U.S. It is responsible for drug interdiction into or out of the U.S.
3. **Internal Revenue Service.** Enforces the federal tax law. In the 1980s, it was made responsible for enforcing money laundering statutes.
4. **Bureau of Alcohol, Tobacco, and Firearms.** Responsible for investigations involving firearms, explosives, interstate arson, and liquor violations.

The U.S. Postal Service has a law enforcement agency called Postal Inspection. Postal inspectors investigate mail fraud and mailing of obscene and dangerous materials.

There are other federal law enforcement agencies in the other departments. The Defense Department has its investigative services. The Environmental Protection Agency enforces federal pollution laws. The list goes on.

Like the states' enforcement agencies, the federal law enforcement agencies usually require higher standards and education. The crimes that federal agents investigate are sophisticated and require a high degree of knowledge and expertise in their respective areas. Each department trains its agents not only in law enforcement, but also in the laws in the respective fields.

## 25.7 Foreign Law Enforcement

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Most countries maintain a national police agency. Some countries have a national police agency that also doubles as a military force. In Britain, police are under local control, but the home office sets nationwide standards.

Several large criminal organizations operate on an international scale. This makes it hard for law enforcement to investigate and prosecute such people. Criminals will flee from



one country and seek refuge in another to avoid prosecution. Police in one country have difficulty in obtaining information and cooperation from another country. In 1923, the International Criminal Police Organization (Interpol) was formed for the purpose of promoting mutual assistance among international law enforcement authorities. This assistance includes coordinating and aiding international arrests and extraditions and providing a way to expedite the exchange of criminal justice information. At the present time, there are 125 members of Interpol. Interpol is not an international police agency but a conduit for cooperative exchange of criminal information to help detect and combat international crime. Each participating country sets up a national central bureau that serves as the country's point of contact with the international law enforcement community. Each country operates its national central bureau within the parameters of its own national laws and policies. In the U.S., the Interpol function rests by law with the attorney general. The U.S. National Central Bureau (USNCB) is under the control of the Departments of Justice and the Treasury.

Agents, analysts, communicators, translators, and clerical support personnel staff the USNCB. Most employees are with the Department of Justice. However, other federal and state law enforcement personnel are detailed on a regular basis. With the increase of international crime, the USNCB has arranged with the states a point of contact for a full range of international services. The liaison office in that state forwards requests for investigative assistance from abroad, which requires action by the police of a particular state, to the USNCB. Interpol provides the following services:

1. Criminal history checks
2. License plate/driver's license checks
3. Full investigation leading to arrest and extradition
4. Location of suspects, fugitives, and witnesses
5. International "wanted" circulars
6. Traces of weapons or motor vehicles abroad
7. Other types of criminal investigations

## 25.8 Misdemeanor vs. Felony

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In the U.S., crimes are divided into two categories: misdemeanors and felonies. Misdemeanors are generally considered trivial crimes. They impose incarceration at local detention facilities and/or fines and penalties of relatively small amounts. Parking and traffic violations are considered misdemeanors. Improper use of property or authority can be classified as a misdemeanor. Misdemeanor crimes are usually heard before a county or municipal judge or magistrate. There are no juries. The judge or magistrate serves as both judge and jury. The people that are found guilty of misdemeanor crimes do not go to state detention facilities. In most cases, they only pay fines. Some states divide misdemeanors into grades according to the degree of seriousness, such as gross misdemeanors and petit or simple misdemeanors.

A felony is a crime that is or may be punishable by death or imprisonment in a state prison. The possible sentence, not the actual one imposed by the court, determines the grade of the violation of law and whether the crime is a felony or misdemeanor. Before a person can be punished, the person's acts must be plainly and unmistakably prohibited or

compelled by a statute. Any and every reasonable doubt must be resolved in favor of the accused, inasmuch as personal liberty and perhaps life are at stake. This principle of strict construction does not require that a criminal statute be given a narrow meaning. The language of the law is to be given its natural, reasonable, and accepted meaning in an effort to determine the legislative intent. The law distinguishes crimes as *mala in se* (bad in themselves) and *mala prohibita* (bad because prohibited). Acts such as murder, arson, rape, and robbery, which obviously are evil in themselves and inherently violate the mores of society, are classified as *mala in se*. Other acts, which are deemed wrong only because a specific law declares them to be wrong, are classified as *mala prohibita*.

## 25.9 Hearings

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Hearings are informal trials before a county or municipal judge or magistrate. There are no juries. The local judge or magistrate acts as both judge and jury. These hearings handle misdemeanors, bond or bail arrangements, criminal arraignments, and small civil disputes. The federal courts use hearings for bail or bond arrangements, sentencing, and some civil disputes.

## 25.10 Grand Jury

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A grand jury is so called because it normally has more members than the ordinary trial jury. A grand jury consists of 16 to 23 people. However, some states have statutes that mandate fewer people. Grand juries may be impaneled under either federal or state law, and classified as a regular or special grand jury, depending on the reason they are convened. A regular grand jury is so designated because it is routinely impaneled to perform the function of a grand jury and is the forum for presentation of cases developed through the normal investigative processes of law enforcement agencies. The court, often at the request of a state or U.S. attorney to investigate specific complaints or allegations of crime, convenes special grand juries. Special grand juries may be convened to investigate potential crimes involving casinos, union pension plans, and corruption in public agencies or offices.

### 25.10.1 History

It is generally agreed that the grand jury originated in England as an investigatory tool for the Crown, its development usually being traced from the Assize of Clarendon, which was proclaimed by Henry II in 1166. However, its defined purpose in exercising its accusatorial and investigative function emerged as one of protecting the accused against unfounded charges rather than of furthering arbitrary prosecutions at the will of the sovereign. By the time the grand jury was brought to this country by the early colonists, it was firmly established in the common law as an important institution for the protection of citizens' rights and privileges. This historical protective function of the grand jury was incorporated into the Fifth Amendment to the Constitution as a guarantee that "no person shall be held to answer for a capital, or other infamous crime, unless on a presentment or indictment of a Grand Jury." Scholars of U.S. constitutional law generally regard the modern grand jury as part of the judicial, rather than the executive or legislative, branch of government.

### 25.10.2 Rule 6, Federal Rules of Criminal Procedure

The adoption of the Federal Rules of Criminal Procedure in the 1940s established the first concise definition of federal grand jury procedural requirements. Rule 6 defines the role and procedures for federal grand juries. The following is a synopsis of Rule 6:

1. **Generally.** The court shall order one or more grand juries to be summoned at such time as the public interest requires. The grand jury shall consist of not less than 16 and not more than 23 members.
2. **Objections.** The attorney for the government or a defendant who has been held to answer in the district court may challenge the array of jurors on the ground that the grand jury was not selected, drawn, or summoned in accordance with law. He may challenge an individual juror on the grounds that the juror is not legally qualified. Challenges shall be made before the administration of the oath to the jurors and shall be tried by the court.
3. **Foreperson.** The court shall appoint one of the jurors to be foreperson and another to be deputy foreperson. The foreperson shall have power to administer oaths and affirmations and shall sign all indictments. The foreperson is responsible for keeping a record of concurring findings of every indictment. During the absence of the foreperson, the deputy foreperson shall act as foreperson.
4. **Who may be present.** Attorneys for the government, the witness under examination, interpreters when needed, and, for the purpose of taking the evidence, a stenographer may be present while the grand jury is in session, but no person other than the jurors may be present while the grand jury is deliberating or voting.
5. **Disclosure.** A grand juror, an interpreter, a stenographer, an attorney for the government, or any person to whom disclosure is made shall not disclose matters occurring before the grand jury. A violation of Rule 6 may be punished as a contempt of court.
6. **Return of indictment.** An indictment may be found only upon the concurrence of 12 or more jurors. The indictment shall be returned by the grand jury to a federal magistrate in open court. If a complaint or information is pending against the defendant and 12 jurors do not concur in finding an indictment, the foreperson shall so report to a federal magistrate in writing forthwith.

### 25.10.3 Secrecy

The requirement that secrecy of grand jury proceedings be maintained is one that developed gradually in English common law to protect the independence of the grand jury. Five reasons are traditionally given in modern common law for this requirement:

1. To encourage the free expression of witnesses by affording them the maximum freedom of disclosure without fear of reprisal
2. To prevent perjury by witnesses who might otherwise come forward to falsely controvert or reinforce other grand jury evidence, which they might learn about
3. To permit confidentiality of the grand jury's interest in order to prevent prospective defendants from fleeing
4. To prevent disclosing knowledge of investigations that results in no grand jury action
5. To assure the grand jury freedom from outside interference

## 25.11 Pretrial Procedures

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After the information (complaint) or indictment has been rendered, the defendant will appear before a judge or magistrate for arraignment. The defendant's lawyer may force the prosecution by use of a writ of habeas corpus, the substantive reasons for depriving the accused of liberty. Bail is also set during the arraignment. The defendant can file motions. These motions fall into two classes:

1. Motions to correct defects in the complaint
2. Motions for judgment upon the complaint in favor of the defendant

All motions addressed to the complaint must be made promptly. The rules of procedure governing this type of relief generally provide for specific time limitations within which such motion practice is available to the defendant.

In most states, provisions for the examination before trial of a party and of a witness have been expanded and liberalized. The practice of taking the testimony of parties and witnesses is a common one. The main objective of examination before trial in all jurisdictions is to allow a party to obtain material and necessary evidence for the prosecution or defense of an action. Going on fishing expeditions is not permitted. Depositions must contain both direct examination and cross-examination of a witness before they can be admissible in court. The court can suppress (forbid the use of) depositions for a variety of reasons, including fraud, unfair and overreaching conduct, improper or irregular procedure in taking or returning a deposition, and evasiveness or refusal of witnesses to answer questions put to them on cross-examination.

## 25.12 Trial

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After arraignment, pretrial motions have been ruled upon, and discovery (providing the defense all the evidence that will be used in trial) has been made, then the case is ready to go to trial. The purpose of the trial will be to determine the issues of fact. The court determines questions of law. The trial is conducted by stringent rules regarding both evidence and procedures. There are seven stages of a trial, as explained below.

### 25.12.1 Jury Selection

Jury members have to be selected. Usually, there are 12 jurors who have to be selected along with one or more alternate jurors, so that if a juror becomes ill or otherwise unable to complete the trial, an alternate may be substituted for such disabled juror without any disruption of the proceedings. This selection process is called *voir dire* examination. Both prosecution and defense examine prospective jurors about their qualifications to serve. The objective is to determine which jurors will reach an objective verdict without any biases or prejudices. A challenge to the poll is an objection to an individual prospective juror. Such objection may be for cause or peremptory. A challenge for cause may ordinarily be either for principal cause or to the favor. Principal cause involves the legal presumption that a juror would not try the case fairly, for example, if there is a close relationship between the prospective juror and a party to the action. A challenge to the favor is merely an assertion of a suspicion rather than a legal presumption that the juror will be prejudiced

in the trial of the case. The court may dismiss a juror at any time before evidence is given in the action. In a peremptory challenge, no reason need be given. Peremptory challenges vary according to the crime charged. If the crime charged is punishable by death, 30 or more peremptory challenges may be allowed. If the crime is punishable with imprisonment for life or for a term of 10 years or more, 20 challenges are normally available. In all other criminal cases, law permits about five peremptory challenges.

### **25.12.2 Opening Arguments**

Opening addresses to the jury by both plaintiff and defendant are the next order of procedure. The purpose of counsel's opening remarks to the jury is merely to advise the jury of the general nature of the issues, which the jury ultimately will have to determine. Usually, counsel tells the jury what the counsel expects (or hopes) to prove during the trial.

### **25.12.3 Evidence by the Prosecution**

The prosecution has to present its evidentiary facts. Although it is true that evidentiary facts, for the most part, are adduced by the testimony of witnesses, there are in fact four methods of proving a case:

1. Presenting oral statements of sworn witnesses
2. Requesting the court to take judicial notice of matters of law
3. Offering in evidence documents that require no witnesses for their introduction
4. Offering in evidence documents identified by the oral testimony of a sworn witness

It is apparent that witnesses are often necessary, not only to testify to material evidentiary facts within their own knowledge, but also to identify documents that would otherwise be inadmissible in evidence. If proper identification is made and a foundation is laid for the introduction of such documents in evidence, the facts contained in them may then be used by counsel to prove the allegations of the pleadings. No unsworn testimony is admissible in courts. Defense counsel has the right and obligation to cross-examine the prosecution's witnesses.

### **25.12.4 Evidence by the Defense**

After the prosecution has presented its case, the defense presents its case. Counsel's questions must be competent, relevant, and material, and should conform to the well-established rules of evidence. Except to the limited extent permitted by specific statute, parties may not impeach their own witnesses; that is, parties may not call witnesses to prove that their prior witness's general reputation is bad, that the witness is unworthy of belief, or that the witness made contradictory statements out of court. A witness must generally be asked questions that he or she can answer with evidentiary facts within his or her own knowledge, unless called as an expert witness, in which event he or she may give opinion evidence. Leading questions are not permissible on direct examination unless the witness called by counsel is a hostile witness or an adverse witness. If opposing counsel deems a question put to a witness to be improper in form or content, counsel may object and have the court rule on such objection. Regardless of the nature of the objection, it should always be made as soon as the question is put to the witness and before it is answered. Sometimes,

the witness's answer comes so fast that counsel is unable to make the objection first. In this event, if the objection is a proper one, it will be deemed timely and the court will order the answer stricken from the record. In reality, nothing is stricken from the record.

### **25.12.5 Closing Arguments**

Both sides are allowed to make closing arguments after presenting their case. Closing arguments are basically a summation of their case. They make their points in their case as previously presented to the jury. The prosecution presents its closing argument first. The defense then presents its closing argument, which is followed by the prosecution's rebuttal.

### **25.12.6 Jury Deliberations**

After the closing arguments, the court will give the jury instructions regarding the law and its application to the issues involved. The law must be applied as charged, as presented to the jury by the trial court, regardless of whether the jury agrees or disagrees with it. Simply stated, the jury is the trier of the facts, while the court determines and instructs as to the applicable principles of law. It is well established in this country that the jury alone is responsible for determining questions of fact. The jury is bound only by its recollections and interpretations of the evidence adduced at the trial, and not by the court's statement of fact in its charge. In fact, if the court calls material facts not in evidence to the attention of the jury, the charge will be deemed improper and a reversal will undoubtedly result.

### **25.12.7 Verdict**

After the court has charged the jury, the jury will be secluded for its deliberations. The jury will take the case and decide it upon the evidence, without sympathy or prejudice, with the sole desire of eliciting the truth and establishing such truth by a fair verdict. The jury may vote by either open or secret ballot on the innocence or guilt of the defendant. The foreperson will usually count the votes. In capital cases, each member of the jury must find the defendant guilty. Any one dissension will result in a hung jury, in effect no verdict. Once a verdict has been reached, the foreperson will either read the verdict in open court or have the verdict delivered to the court for open reading.

If the defendant is found not guilty of the offense(s), then he or she is able to walk out of the courtroom as a free person. If the defendant is found guilty of all or part of the charges, then the defendant will be taken to the detention facilities for further disposition. The court will order a sentencing hearing. The prosecution and defense will have to prepare for this hearing.

## **25.13 Plea Bargaining**

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Some criminals, especially those who know that they are guilty, want to plea bargain. Plea bargaining is a way of getting more lenient treatment. These criminals know that if they go to trial and are found guilty, then they could get a harsher sentence. In areas where the courts are overloaded with cases, plea bargaining is welcomed. It reduces the time and expense of trial, and saves the taxpayer money. Plea bargaining could involve the reduction of charges from a felony to a misdemeanor. Also, it could mean that the defendant would serve less time in a local stockade, instead of serving longer in a state prison. There are

many arguments for and against plea bargaining. Plea bargaining can offer swift justice. On the other hand, it does not get hardened criminals off the streets and also does not rehabilitate criminals.

## 25.14 Sentencing

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Prior to 1984, judges had a lot of leeway in determining sentences for convicted criminals. Sentences ranged from 2 years and up, depending on the crime. However, in 1984, the Crime Control Act was passed. This act provides sentencing guidelines that the U.S. court system must follow. It mandates the possible sentences for a particular crime. The U.S. Supreme Court, on January 18, 1989, upheld the new sentencing guidelines in *Mistretta v. United States*. These new sentencing guidelines came about because:

1. A criminal, presumably, will not go straight.
2. The system was unfair because of different sentences for the same type of crime.
3. The public was disillusioned with the rehabilitation process.

Prior to sentencing, the judge will order a presentencing investigation. The purpose of this investigation is to determine the appropriate sentence. Both the prosecution and defense will present their opinions and facts. The convicted criminal's background will be examined. Prior convictions for the same or similar acts will influence the judge to hand out a harsher sentence. However, the judge can be influenced to issue a lighter sentence because of family life, community involvement, and the seriousness of the offense.

At the sentencing hearing, the judge will hear arguments from both the prosecution and the defense. The defendant will also have the opportunity to express his or her case. *In nolo contendere* (no contest) cases, the judge will ask the defendant if he or she knows the consequences of the decision not to contest the charges. Judges are not bound to give a lesser sentence if the defendant pleads out. After hearing all arguments, the judge pronounces the sentence.

## 25.15 Punishment

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There are various forms of punishment that a judge can mete out:

1. **Jail.** The criminal will be sent to a local detention facility for a term of up to 1 year.
2. **Prison.** The criminal will be sent to a state or federal prison system for a term of 1 year or more. Most criminals would rather go to a federal prison than a state prison because conditions in state prisons are generally harsher and more inhumane than federal prisons. Criminals sentenced 10 years or less in the federal system will go to prisons that are called "Club Fed" because they do not have the harsher rules and regulations that the state prisons have imposed.
3. **Probation.** The criminal will not go to prison or jail, but will be required to live by a set of rules, which are enforced by a probation officer. The criminal will only be allowed to do certain activities, and will be forbidden to do other activities. The probation officer is expected to help the criminal, and also to keep the criminal

out of further lawbreaking activities. Another version of probation is house arrest. Criminals are not allowed to leave their home without permission. They wear an electronic device, which will alert authorities of their whereabouts or if they leave a designated area. Removing the electronic device will alert authorities that they have violated the probation and result in a return to jail or prison.

4. **Community service.** In misdemeanor or minor felony cases, the judge may order the criminal to perform community service. Community service includes, but is not limited to, cleaning up parks and roads and helping the elderly or children. This is done without any compensation. A specific number of hours or days is specified. This form of punishment is becoming more popular because it helps cities and municipalities in economic hard times by reducing the cost of detaining people in jails or prisons and by reducing the cost of hiring personnel to perform these functions. Another version of this form of punishment is the halfway house. These houses are mostly directed at rehabilitation of drug and alcohol offenders.

## 25.16 Summary

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Forensic accountants must be familiar with the judicial system and how it works since they will be involved in the system in one way or another. It is not unusual for forensic accountants to be involved from the start to the finish. This means that they will be involved:

1. From the initial investigation
2. To presenting evidence to a grand jury
3. To testifying in trial
4. To presenting expert testimony in civil proceedings following the criminal case

Forensic accountants are involved in all phases of the judicial system.







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## 26.1 Introduction

Criminologists study crime and justice within the social order. Sociologists study society and its social order. Some scholars think of criminology as a field of sociology, whereas others view it as a field of psychology. Criminology in recent years has become a separate field of study while it has incorporated some of the theories from both sociology and psychology. Sociologists have been instrumental in helping law enforcement understand organized crime and youth gangs. Psychologists have helped law enforcement understand criminals' behavior. The FBI has developed a method called profiling. This method uses crime scene evidence to determine the psychological makeup of a criminal. It is also used by other law enforcement agencies to identify drug traffickers, serial killers, and rapists. This chapter provides an overview of the field of criminology and the basic theories.

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## 26.2 History

The field of criminology did not emerge until the 18th century when an Italian, Cesare Beccaria (1764), wrote the essay "On Crime and Punishment." An English contemporary, Jeremy Bentham, wrote *Principles of Morals and Legislation* (1789). These two individuals are considered the founders of criminology. A century later, several other schools of criminology developed. One of the schools was labeled the Positivists School. This school was promoted by Cesare Lombroso and his followers, Enrico Ferri and Raffaele Garofalo. The other school was the Conflict School. This school was originated by the writings of Karl Marx in *Das Kapital* (1867–95).

During the 19th century, other professional groups developed theories for criminal behavior. An Austrian physician, Dr. Franz Josef Gall, formulated the theory of phrenology. Charles Caldwell promoted this theory in the U.S. and it was widely accepted. This theory was rebutted in 1913 by Charles Goring in his research. However, Ernest A. Hooten partially confirmed some of Gall's theories in 1939. In the field of psychology, Sigmund Freud had a big impact upon criminology, even though this was not his intention. Criminologists still rely on many of his theories and methodologies.

Sociologists have become involved in criminology in various ways. They are classified into four groups or schools. These schools were developed during the late 19th and early 20th centuries. These theories are:

1. Control
2. Strain
3. Cultural deviance
4. Symbolic interaction or differential association

The control theories were promoted by Travis Hirschi in his 1969 book *Cause of Delinquency*. Control theories originated from Emile Durkheim in the late 19th century and were expanded upon by Thorsten Sellin (1959).

The strain theories are also based on the works of Emile Durkheim, but they were adapted by Robert Merton (1938) for application in the U.S. Other sociologists have expanded upon Merton's strain theories by developing additional theories, i.e., deprivation theories and institutional anomie theories. Anomie, according to Durkheim, means a condition of an individual or society characterized by a breakdown of norms and values.

The cultural deviance theories were developed by Edwin H. Sutherland (1939) in his book *Principles of Criminology*. He was influenced by colleagues at the Sociology Department of the University of Chicago. His theories are closely related to the symbolic interaction theories by George Mead and others.

The symbolic interaction theories and the differential association theories were developed by George Mead in *Mind, Self and Society* (1934). This symbolic interaction theory is usually referred to as labeling theory or just social interaction theory.

Another school in criminology is radical criminology. The founder of this school was Ralf Dahrendorf, a sociologist, but the school was applied to criminology by George Vold in his writing *Theoretical Criminology* (1958). Radical criminology is closely associated with Marxist theories. Also, radical criminology is similar to conflict theories. Richard Quinney developed criminology theories that were closely related to Marxist ideas in his writing *The Social Reality of Crime* (1970). William Chambliss and Robert Seidman were proponents of radical criminology.

### 26.3 Schools of Criminology

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There are many theories advocated in the field of criminology. These theories are classified as schools. The field of criminology has been influenced by other professions. The medical profession has made propositions that physical characteristics make criminals. This is especially the case in phrenology. Psychologists and psychiatrists believe mental disorders and processes produce criminals. Sociologists advocate that social influences cause people to become criminals.

Some of the criminology theories are closely intertwined. This is especially the case with Marxist theories and the conflict and radical theories. It is hard for one to distinguish the differences. The criminologists are usually more concerned with justice and human rights, whereas the sociologists are concerned with social order and harmony. In reality, human rights and justice are so intertwined with social order and harmony that they cannot always be clearly distinguished.

### 26.3.1 Classical School

The Classical School, founded by Cesare Beccaria and Jeremy Bentham, was based on society that is composed of individuals. Society must impose laws to regulate the conduct of individuals within the society. Individuals form a society in order to obtain life, liberty, and happiness. This requires individuals to give up some liberties and be responsible to society for their actions and deeds. Their main concepts were:

1. Conduct is chosen by individuals within a society.
2. Punishment is a deterrent for unwanted conduct.
3. Punishment should fit the crime.

Bentham proposed his theory of felicity calculus, which was his mathematical model of determining the amount of punishment to be imposed in order to deter an individual from committing a crime. This model was based on his estimation of pain. The Classical School had an influence on the founding fathers of the U.S. when they incorporated cruel and unusual punishment into the Eighth Amendment of the Constitution.

### 26.3.2 Positivist School

The Positivist School was interested in criminal behavior at the individual level. It also embraced scientific methodologies more than philosophizing, as the Classical School had done. The major proponents of the Positivist School were Cesare Lombroso and his followers, Enrico Ferri and Raffaele Garofalo. Lombroso studied Italian criminals. Based on his studies, he formulated that degeneracy, called atavism, caused criminality. He classified criminals into three categories:

1. **Pseudocriminals.** Involuntary crimes such as self-defense.
2. **Criminaloids.** Predisposed to crimes because of environmental causes.
3. **Habitual criminals.** Criminals who choose to be because of environmental or biological factors.

Lombroso and his colleagues were proponents of criminal anthropology. In other words, heredity was the cause of criminal behavior in some instances. In America, the theory of biological causes to crime was accepted better than it was in Europe.

### 26.3.3 Conflict School

This school followed the theories of Karl Marx, a 19th-century sociologist. Crime is considered a class struggle between the lower and upper classes for political and economic power. Crime is defined as acts of the lower class, which are prohibited by the ruling upper class. This conflict is over the control of scarce resources. Marx engenders a parasitic class of people whose interest is living off other classes, both upper and lower. This parasitic class consists of thieves, burglars, prostitutes, and gamblers.

## 26.4 Biological Theories

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The Positivist School was the first to theorize biological causes for criminal behavior. Ernest A. Hooton, an anthropologist, conducted 12 years of research on over 17,000 subjects. Nearly 14,000 subjects were incarcerated in jails and prisons, and the remainder were citizens. He concluded that criminals have physiological differences that set them apart from the general population. He believed tattooing was done more by criminals than others.

An Englishman, Charles Goring, previously made a similar study in England. He conducted 8 years of research on 3,000 convicts. He concluded that criminals have low intelligence and that this is an indication of hereditary inferiority. Charles Caldwell, a phrenologist, conducted a study of 29 women convicted of infanticide. He found that most of them were poorly developed as to their sense of caring for children.

## 26.5 Psychological Theories

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This school believes that the minds of criminals are the cause of their behavior. The psychological theorists explain behavior as mental anomalies. The best-known psychologist was Sigmund Freud. He conceived that mental conflict was due to three incompatible elements of personality. He identified these personality elements, which must be in balance, as:

1. **Id.** This is the unconscious, which is composed of forces called instincts and drives.
2. **Ego.** This is the part of the personality that deals with reality. This is the conscious part.
3. **Superego.** This is the conscience. It internalizes a person's values and norms.

From the Freudian perspective, crime is caused by the dysfunction of the ego and superego. Criminologists rely upon Freudian theories to explain the motives for criminal behavior. Freud's theories were not addressed to explain criminal behavior, nor did he expect them to be used in this field.

## 26.6 Sociological Theories

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Sociologists have developed many theories to explain normal and abnormal behavior. They have also presented theories on the causation of crime. Their basic theme is based on external factors. These external factors involve political, economical, and ecological elements. Some of the sociological theories are intertwined. These theories can be grouped into four classifications:

1. Control
2. Strain
3. Cultural deviance
4. Symbolic interaction or differential association

### 26.6.1 Control Theory

There are many theories that can be classified as control theories. Some of these are containment and anomie theories. Durkheim was the earliest proponent of the social control theory. He believed order and conformity to rules were important for social solidarity. Criminals are individuals who will not adapt to the social norms of society. Robert Merton, as well as Travis Hirschi, formulated elements that would strengthen social bonds:

1. **Attachment.** Refers to the individual's feelings about others.
2. **Commitment.** Refers to the individual's personal stake in society.
3. **Involvement.** Refers to the amount of time and resources the individual provides to society.
4. **Belief.** Refers to the individual's beliefs in adhering to society's rules.

### 26.6.2 Strain Theory

The strain theory is very similar to the control theory. Both of these theories come from the Chicago School of Sociology. Merton views society in two parts: cultural and social structures. Cultural structure refers to society's goals, while social structure refers to society's means of achieving the goals. Merton proposes different ways people respond to strain:

1. **Innovation.** Deviant behavior is a response to society's blocking the individual's goals.
2. **Ritualism.** Refers to individuals adhering to society's rules, but at a lower degree.
3. **Retreatism.** Refers to individuals who drop out of society since they are unable to achieve the goals that society wishes for them.
4. **Rebellion.** Refers to individuals who do not accept cultural and social structure and seek to replace them.
5. **Conformity.** Most people accept society's goals and the means to achieving them.

### 26.6.3 Cultural Deviance Theory

The cultural deviance theory is closely related to the strain theory. Thorsten Sellin argued that crime is caused by the conflict between cultures. Society makes laws for the majority, middle, or dominant class. These laws can conflict with the values and norms of minority or ethnic groups, who have their own sets of values. In a heterogeneous society, laws represent the majority or dominant cultures.

### 26.6.4 Differential Association Theory

The differential association theory is closely associated with cultural deviance theories. The chief proponent of this theory is Edwin Sutherland. He suggested nine propositions:

1. Criminal behavior is learned.
2. Criminal behavior is learned through a process of communication.
3. Criminal behavior occurs in close groups.
4. Learning criminal behavior includes how to commit crimes and provides the motives and drives to do them.

5. Motives and drives come from legal definitions.
6. It is more favorable to commit crimes solely.
7. Criminal behavior varies by the frequency, duration, priority, and intensity of association.
8. Criminal behavior is learned by association with other criminals.
9. Criminal behavior does not explain general needs and values.

## **26.7 Symbolic Interaction Theory**

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The symbolic interaction theory is based on the belief that people communicate through symbols. A symbol is anything that has meaning in an individual's life. The interpretation of symbols is dependent upon each individual. Different individuals will have different interpretations based on their experiences. Symbolic interaction is a forerunner to the labeling theory.

## **26.8 Labeling Theory**

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The labeling theory expands upon the symbolic interaction theory. It proposes that people are given various symbolic labels by interaction with people around them. These labels connote behavior and attitudes. Labeling has both a positive and negative effect. When a person is labeled as conscientious, intelligent, thrifty, or trustworthy, then this implies a positive view of the person. On the other hand, if the person is labeled as lazy, stupid, or troublesome, then this implies a negative view of the person. These labels do not have to be truthful. Labeling applies not only to individuals, but also to various minority and ethnic groups. Labeling theorists believe that police, courts, and other agencies promote criminal behavior by use of labeling. Label theorists point out that crime is a matter of definition. What may be illegal at one particular time or place may not be illegal at another time or place. Gambling and alcohol consumption are illegal in many places today, yet they are legal in other places in the U.S. today.

## **26.9 Critical Criminology**

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Radical criminology is heavily influenced by critical criminology. The major proponents of critical criminology are Ralf Dahrendorf and George Vold. Dahrendorf is a sociologist who advocated that society is divided into two classes: the domineering class and the dominated class. He applied critical theories to societal issues. George Vold applied critical theories to criminology. Vold explained crime and deviance as caused by conditions of inequality. This was made explicit by inner-city riots and political protests. The conflict theory is limited to situations where criminal acts of one group collide with another group.

## **26.10 Radical Criminology**

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The chief spokesman for radical criminology is Richard Quinney. Other supporters are William Chambliss and Robert Seidman. Radical criminology is very much Marxist

oriented; it applies the social theories of Karl Marx to criminology. Quinney made six propositions concerning the definition of crime. These definitions can be condensed to the premise that those in power make laws to benefit and maintain their power, while restraining those not in power. Laws are ever changing to reflect changes in the political climate of society. Chambliss and Seidman also advocate that the state, even though an instrument of the ruling class, must be concerned with maintaining good relations between classes. It must balance the capitalistic society and personal interest of individuals. They point out that law enforcement is selective. Just because a law is on the books does not mean it is enforced.

## 26.11 Scientific Methodology

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Scientific methodology encompasses procedures used to search for the truth. These procedures try to eliminate human intuition and hunches and make the research more objective and verifiable. Research methodology tries to guard against the following:

1. **Errors in observation.** Some people fail to recognize important features of a crime scene. Witnesses who cannot remember details of an event have been observed in court. Some witnesses make up observations that have contradictions when analyzed.
2. **Selective observation.** People only see things that they are interested in seeing. Witnesses in trials can only give facts from their observations.
3. **Errors in interpretation.** Everyone has some biases and prejudices. These cause misinterpretations.
4. **Dependence upon authority.** People rely heavily on others in authority. Juries hear expert witnesses. Expert witnesses can only express opinions based on data supplied to them. Expert witnesses have their biases and prejudices. News media reports can be slanted or biased. The headlines of one media vehicle may not be reported by another, or given a lower priority.
5. **Inappropriate use of evidence.** Evidence may be appropriate in one situation, but inappropriate in another situation. Police sometimes report more than one offender, but only arrest one person.

There are two recognized research methods in academia. They are qualitative and quantitative. Criminology uses both.

## 26.12 Organized Crime

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Many criminologists study the various aspects of organized crime. They are interested in its motives, organization, criminal activities, and individual and group profiles. In Chapter 12, different organized crime groups are identified, along with their basic organization and criminal activities. Law enforcement is always gathering intelligence on criminal organizations and their activities. Many large city police departments as well as some state and federal agencies have units whose sole responsibility is to investigate various organized crime groups.



### 26.12.1 Organized Criminal Code

Organized criminal groups cannot function without some kind of code for their members to follow. This code is well defined in some organizations, while it is not well defined in others. The code can vary from one criminal organization to another. Criminologist Donald Cressey made an analysis of organized crime, and he suggested the following:

1. **Loyalty.** Do not be an informer.
2. **Be rational.** Conduct business in a quiet, safe, and profitable manner.
3. **Be a man of honor.** Respect women and elders.
4. **Be a stand-up guy.** Show courage and heart. Keep your mouth shut.
5. **Have class.** Be independent.

### 26.12.2 Rules of Behavior

Donald Cressey found three basic rules of behavior in studying the Lupollo crime family:

1. Primary loyalty is vested in family, not in individual lineages.
2. Each family member must act like a man and not bring disgrace on the family.
3. Family business is secret; do not discuss it outside the group.

### 26.12.3 Survival Mechanisms

Organized crime contains mechanisms that ensure the survival of the organization. The La Cosa Nostra (LCN) has a long history in both the U.S. and Italy. The Triads and Yakuza also have a long history. Even with losses from both external and internal forces, the LCN, the Triads and Yakuza have been able to survive and prosper. They have learned to become more sophisticated in their methods of operations and use of professional people, e.g., accountants, lawyers, and engineers. These survival mechanisms are classified into three imperative roles:

1. **The enforcer.** A position in the organization that provides for enforcement of its rules and the directives of those in authority. The methods can range from verbal warnings to murder.
2. **The buffer.** A position primarily centered on internal communication and the flow of decisions in the hierarchy. This person keeps lines of communication between leaders and followers open, forewarning of internal dissensions and problems at the street level. The buffer may settle disagreements and conflicts.
3. **The corruptor.** The corruptor's job is to bribe, buy, intimidate, negotiate, persuade, and maneuver into a relationship with police, public officials, and anyone who will help the family.

## 26.13 Predatory Crimes

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Crimes that members of society fear most are predatory crimes. These are defined as "illegal acts where someone intentionally takes or damages the person or property of another." Criminologist Lawrence Cohen says predatory criminal events involve the following elements:

1. Motivated offenders
2. Suitable targets
3. The absence of capable guardians

If any one of these elements is lacking, the predatory criminal event will not occur.

## 26.14 Legal Definition

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According to law, specific criteria must be met for an act to be considered a crime and the predator a criminal:

1. There must be conduct (not mere thoughts).
2. The conduct must constitute social harm.
3. Law must prohibit the conduct.
4. The conduct must be performed voluntarily.
5. The conduct must be performed intentionally.
6. The conduct must be punishable by law.

Natural crime consists of acts that are repulsive to most people in society. This is *mala in se*, which means “evil in itself.” *Mala prohibita in se* means “evil because it is forbidden” and consists of acts that are illegal by legislation or custom.

Procedural and substantive criminal law draws two basic issues in law:

1. How the authorities handle matters of law and deal with law violators — the question of procedures.
2. Content of specific rules making up the body of criminal law — the question of substance.

## 26.15 Primitive Law

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Primitive law is a system of rules and obligations in preliterate and semiliterate societies upon which modern legal systems are based. Primitive law contains three important features:

1. Acts that injure or wrong others are considered private wrongs.
2. The injured party or family typically takes personal action against the wrongdoer.
3. This self-help justice usually amounts to retaliation in kind.

The Code of Hammurapi is the earliest law and covered a wide range of crimes. Four important observations are:

1. Most laws are a product of prevailing social, political, and economic conditions.
2. Some laws articulate long-established customs and traditions and can be thought of as formal restatements of existing mores.

3. Some laws reflect efforts to regulate and coordinate increasingly complex social relations and activities.
4. Some laws display prevailing ethical and moral standards and show close ties to religious ideas and sentiments.

## 26.16 Criminology and the Fraud Examiner

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Fraud examiners should be aware of sociology and criminology because these help fraud examiners understand the criminal and the motives involved. Sometimes the examiner is questioned about personality profiles that would help distinguish those who would commit a particular crime from those who would not. There is no clear-cut answer to this question. Most employees do not take a job with the view of committing a crime. Employees that commit a crime do so because of internal and external influences. The fraud examiner should be alert to all possible influences that would cause an employee to commit fraud. Some of these influences are:

1. Management committing fraudulent acts, i.e., padded expense accounts, embezzlement, skimming, using ghost employees, and a whole host of other schemes.
2. Failure to obtain a desired position or promotion.
3. Low morale by the employee and/or his or her coworkers. This can be the result of bad policies or layoffs due to bad economic times.
4. The employee has problems at home, i.e., divorce, drug or alcohol abuse, gambling debts, large medical bills, etc.
5. Weak internal controls and the opportunity is present.

People have daily and regular routines. Career criminals also have regular patterns. The fraud examiner should become aware of those patterns. A bust-out artist will open a business and “bust out” months later, leaving creditors holding worthless receivables. “Boiler room” operators will operate in one location for weeks or a few months and then shut down operations. They do this to evade law enforcement. The boiler room operators then move to a new location and start up operations again. Boiler room operators and bust-out artists establish a regular pattern of crime. They usually remain in the same product or service, since they are familiar with it. Once the pattern is determined, the examiner can develop his case to a greater degree. In addition, law enforcement can take the appropriate steps to shut down these operations with minimum effort and a greater degree of prosecution success.

Criminals have various motives for committing the crimes that they do. One major motive is greed. Other motives are to obtain power, status, etc. The fraud examiner should be aware of the motives and patterns that criminals have mapped out.

## 26.17 Summary

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Criminology is the study of crime and causation. Criminology has been influenced by other disciplines, e.g., psychology, anthropology, biology, and sociology. Sociology has had

the greatest impact. The theories for crime and causation vary widely. These theories are classified as schools; the major ones are:

1. **Classical School.** Proposes that the punishment should fit the crime.
2. **Positivist School.** First to use scientific methodology. It theorized that physiology caused criminal behavior.
3. **Radical and Critical Criminology Schools.** Advocate that societal conditions cause criminal behavior. They are closely related to Marxist ideas.
4. **Psychological School.** Believes mental processes cause criminal behavior.
5. **Sociology Schools.** Present many theories for the causation of crime based on various social forces.

Criminologists study various criminal groups. The most common subjects are criminal organizations. Criminologists want to learn how they operate and survive after being combated by external and internal forces. Fraud examiners and investigators need to be familiar with criminology. Criminology can help them understand criminals' motives for their criminal activities.





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## 27.1 Introduction

Physical security is that aspect of security concerned with physical measures designed to safeguard personnel, to prevent unauthorized access to equipment, facilities, material, and documents, and to safeguard them against loss, damage, and theft. Loss prevention is particularly concerned with preventing loss of supplies, tools, equipment, and other materials in use, storage, and transit. Concern is focused not only on the threat of criminal activity and acts of wrongdoing by forces external to the organizational unit, but also on internal causes — theft and pilferage by those who have authorized access, inattention to physical security practices and procedures, and disregard for property controls and accountability. Physical security and loss prevention measures include instructions, procedures, plans, policies, agreements, systems, and resources committed and designed to safeguard personnel, protect property, and prevent losses. Physical security helps remove the opportunity from people who want to commit fraud. An ounce of prevention is worth a pound of cure, as the cliché goes.

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## 27.2 Responsibilities

Security is the direct, immediate, legal, and moral responsibility of all people in a business organization. However, there are officers or other personnel who have direct responsibility for physical security and loss prevention. These personnel have different titles, e.g., security officer or loss prevention officer. Whatever the title, it is their duty to:

1. Manage the organization security and loss prevention program
2. Determine the adequacy of the organization's loss prevention program and identify areas where improvements are required
3. Develop, prepare, and maintain loss prevention and security plans
4. Establish personnel identification and access control systems
5. Provide technical assistance on security matters
6. Participate in planning, directing, coordinating, and implementing procedures for crisis management situations, which pose a threat to the organization

7. Establish and maintain liaison and working relationships with local law enforcement and fire protection authorities
8. Maintain good relations with other managers in the organization with specialized skills or technology in security and loss prevention

### **27.3 Plans**

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Loss prevention and security plans should cover the following points:

1. Identify real property and structures to be protected
2. Identify security areas
3. Identify by location and priority the assets to be protected
4. Assess the threat to such areas
5. Determine legal jurisdiction
6. Determine and identify the necessary resources: funds, staff, and equipment
7. Establish barriers and points of ingress and egress
8. Prescribe the personnel identification and access control systems
9. Identify and procure equipment that will detect or prevent wrongful removal, damage, destruction, or compromise of protected property
10. Determine the number of personnel needed and prescribe their duties
11. Establish and maintain records relating to violations and breaches of security
12. Identify procedures for timely internal reporting of losses
13. Identify procedures for ensuring that all losses, inventory adjustments, and surveys of property are reported to management
14. Advise of legal and administrative procedures and remedies applicable to those found responsible and liable for losses

### **27.4 Evaluation**

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In evaluating the need for and type of protection required for an organization, the following factors should be considered:

1. Overall importance to the organization
2. Importance to the business operations
3. Ease of access to vital equipment and materials
4. Tailoring of security measures to the organization's operations and other local considerations
5. Geographic location
6. Legal jurisdiction of real property
7. Aid and assistance agreements with local authorities
8. Local political climate
9. Adequacy of storage facilities for valuable or sensitive material
10. Accessibility of the activity to disruptive, criminal, subversive, or terrorist elements
11. Possible losses to the organization and their impact on operations
12. Possibility or probability of expansion, curtailment, or other changes in operations

13. Overall cost of security
14. Availability of personnel and material
15. Coordination of security personnel
16. Calculated risk: Dictates that when there are limited resources available for protection, possible loss or damage to some supplies or to a portion of the operations is risked in order to ensure a greater degree of security to the remaining assets, supplies, and operations

## **27.5 Cost of Security**

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Security expenditures should generally be based on the cost of the items to be protected and the damage their loss could cause to the organization and to others. The cost of security is frequently greater than the dollar value of the property and material.

## **27.6 Crisis Situations**

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In evaluating the need for security protection, the possibility of injury to security personnel must be considered. This is especially relevant when addressing measures taken during crisis situations, i.e., bomb threats, fires, robberies, or natural disasters, to limit damage and provide emergency services for containment of the incident to restore the activity to normal operation. Security plans should include preventive measures to reduce the opportunities for introduction of bombs; procedures for evaluating and handling threatening messages; procedures for obtaining assistance and support by local law enforcement; procedures in the event that a bomb or suspected bomb is found on the premises; and procedures to be followed in the event of an explosion.

## **27.7 Security Considerations**

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Security measures to be considered when developing security plans are as follows:

1. Personnel screening and indoctrination
2. Protection for vulnerable points and assets within the organization
3. Security force organization and training
4. Personnel identification and control systems
5. Installation of security hardware, i.e., intrusion detection systems, barriers, access control systems
6. Key and lock control
7. Coordination with other security agencies

## **27.8 Sabotage**

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Sabotage acts can cause destruction equal to acts of war but without fear of retaliation against the hostile war-making capability if successfully carried out. The tools and methods of the saboteur are limited only by skill and ingenuity. Readily available materials can be



used to construct simple but deadly devices. The effectiveness of the saboteur is limited only by his or her ability to gain access to targeted installations. The basic sabotage techniques are as follows:

1. **Mechanical.** Includes introduction of foreign objects into machinery, severing of wires or cables, removing of components, and the mishandling or abuse of equipment.
2. **Arson.** Includes firebombing, electrical shorting, and the use of incendiary agents.
3. **Explosive.** Includes the use of commercial and homemade compounds, contact trip wire detonators, and timed devices.
4. **Psychological.** Includes such things as instigation of labor strikes, personnel disputes, distrust of supervisors, and hostilities between coworkers. Organized crime groups, particularly the La Cosa Nostra (LCN) and the Yakuza, use these tactics to take over businesses.

### 27.8.1 Motives

Saboteurs can be classified into two categories:

1. **Internal.** Internal saboteurs are employees who are often motivated by feelings of revenge, emotional disorder, disgruntlement, or use of drugs or alcohol. Offenders perform these acts to get even with superiors, to halt business operations, or to achieve momentary fame as the “alert discoverer” of a fire or other threat.
2. **External.** Saboteurs outside the business organization commit sabotage because they do not like the organization’s policies or political affiliations. They consider the organization exploitative of people in the community.

## 27.9 Terrorism

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Terrorism is the use of tactics, principally by small groups, designed to create panic and chaos through the use of deadly force, publicity, uncertainty, and coercive acts of violence directed against specific or general targets in the general population. Generally, the goal of terrorist acts is to disrupt or destroy the bond of trust and credibility between government and the population. Acts of terrorism directed at businesses have the potential to destroy facilities, injure or kill employees, impair or delay business operations, and cause incalculable damage through adverse publicity and public perceptions of the incident.

### 27.9.1 Terrorist Methods

Terrorists use the following methods:

1. **Bombs.** Bombs used may be of any degree of sophistication and may be placed to destroy equipment, cause fires, create casualties, etc. Depending on the bomb size and placement, the impact may range from minor to a major crisis.
2. **Ambush.** Rapid ambush attacks may be employed by individuals or small groups to assassinate individuals, eliminate a group of people, or destroy or steal assets in remote locations or in transit.

3. **Armed attack.** An armed attack usually involves one or more diversionary actions carried out by small groups against key personnel or critical assets with the objective of causing disruption of operations and creating adverse publicity. Hostage taking is not a usual tactic in this type of terrorist action unless the attackers are prevented from escaping.
4. **Hostage situations.** A terrorist group may undertake the seizure of a specific hostage for ransom or political bargaining purposes. An armed attack scenario may be used to seize a critical asset (factory, research facility, etc.) when personnel are present in order to use both the asset and the personnel as leverage to bargain for publicity and political advantage. Care must be taken to provide for this possibility in companies that develop or produce high-tech products.
5. **Sabotage.** Terrorist groups may engage in the use of various sabotage methods, already discussed.

## 27.10 Surveys

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The security manager should conduct a security survey at least once a year. These surveys should be designed to show management what security measures are in effect and what areas need improvement, and to provide a basis for determining priorities for funding and work accomplishment.

## 27.11 Threat Assessments

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Based on available information, which can be obtained legally, the business organization should determine the short-, medium-, and long-term threats. Such information must be analyzed to determine what additional security measures are necessary and where security requirements are inadequate. A close liaison with local law enforcement agencies is imperative.

## 27.12 Loss Prevention

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A vigorous loss prevention program is essential. Losses of property may disrupt operations and cost millions of dollars. Losses must be minimized by application of a comprehensive loss prevention program consisting of loss analysis, the proper use of available investigative resources, continuing employee loss prevention education, the application of firm corrective measures, administrative personnel action, and other loss prevention measures when necessary. At a minimum, loss prevention measures should consist of the following:

1. **Loss analysis.** To help identify trends and patterns of losses and gains, for all incidents involving reportable property that is missing, lost, stolen, or recovered, reporting and investigation must be included in an ongoing program of analysis. A continuing loss analysis process should consider the types of material lost; geographic location; times and dates; proximity of personnel; proximity of doorways, passageways, loading docks and ramps, gates, and parking facilities; and activities

adjacent to loss locations. Resulting analyses of loss trends and patterns will be used to balance the allocation of resources available for crime prevention.

2. **Investigative resources.** To prevent or reduce losses of property, it is essential to assign investigative personnel to loss prevention functions. A preliminary investigative capability should exist during all working production shifts (especially night shifts). Local loss analysis program data should be used to program security resources to combat losses.
3. **Loss prevention equipment.** Exterior doors in warehouses, storage buildings, office buildings, and other structures that contain high-value, sensitive, or pilferable property, supplies, or office equipment will be afforded with security protection commensurate with the value and sensitivity of the structure's contents. At a minimum, hinges will be either nonremovable or provided with inside protection, which prevents locked doors from opening even if hinges are removed, and lock/hasp security systems.
4. **Employee education.** Each employee must be indoctrinated in local procedures for preventing property losses as well as responsibility for the care and protection of property under the employee's control. This indoctrination should be included in the employee's initial security education briefing upon employment and annually thereafter.
5. **Discipline.** Administrative actions should be taken against employees or others who are responsible for losses. Depending on the circumstances, civil and/or criminal actions should be taken. Civil actions should be taken to recover losses from the responsible person. If an organization just terminates an employee for theft or embezzlement, it is sending a message to other employees that they can get away with the crime. In addition, the bad employee will go elsewhere and will probably commit the offense again.
6. **Financial responsibility.** Procedures for the issue and control of company property will ensure that strict accountability is established for persons responsible for the property that is reported missing, lost, or stolen. Recoupment action must be undertaken against an individual by which negligence or intention results in missing, lost, or stolen property. This recoupment action is independent of, may be taken parallel with, or be exclusive of any formal criminal procedures arising from the same event.
7. **Claims.** A business organization should have adequate insurance coverage to compensate for any losses due to theft, fire, or other natural disasters. Claims should be filed as soon as possible since the insurance company will probably want to investigate the circumstances of the loss and bring civil actions against the person responsible.
8. **Criminal actions.** Examination of the facts may indicate criminality sufficient to warrant a referral to appropriate legal authorities. This action strengthens the deterrent aspects of loss prevention policies and procedures. The security manager should ensure that the security portion of criminal cases is properly prepared and sufficiently detailed to render it acceptable for prosecution in federal, state, or local courts. The security manager should monitor the progress of criminal issues and maintain a liaison with the legal authorities.

### 27.13 Loss Reporting

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Effective reporting of losses is basic to the determination of the scope of the loss prevention program that must be developed by the company. When reviewing property losses that are not critical to business operations and do not harm anyone, it is important to know whether the expenditure of funds on physical security will pay back in loss reductions. If real losses are extremely low and involve only low-value and nonsensitive materials, it may be more cost-effective to absorb such losses. Nevertheless, actual losses must be reported so that an accurate decision can be made by management. Steps must be taken to ensure that reportable losses and accountable individuals are identified. This can be done by matching property inventories, inventory adjustments, etc., with loss reports submitted. Historically, many audits and inspection reports have shown that not all required reports are submitted and actual losses have greatly exceeded reported losses. In each case of loss, theft, or destruction of property, efforts should be made to determine if the event involved negligence or criminality. The individuals responsible should be determined whenever possible. If an investigation is initiated, the ongoing status of the investigation will be provided during pending or supplementary reports. Incidents involving the same type or class of material are often indicative of a lack of adequate loss prevention and inventory control procedures. Causative factors should be identified and prompt corrective action initiated. Care must be taken to explain the detailed circumstances of a loss. The narrative comments should identify security problems and deficiencies related to the incident. Every report should provide details of any real or perceived security deficiency and any action taken or planned to correct such deficiency.

### 27.14 Area Protection

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It is important to perform an analysis to determine the degree of security required. Criticality and vulnerability of security interest must be evaluated in relationship to ranking potential losses and giving the level of security necessary to ensure the best possible protection for the loss level at efficient costs. Protective area controls are the first steps in providing actual protection against security hazards. These controls are obtained through the use of protective barriers and other security measures. All areas within a business operation must be assigned security area designations. Different areas and tasks involve different degrees of security, depending on their purpose, nature of the work performed, and the information or materials concerned. Areas should be designated as either restricted or nonrestricted. Restricted areas should be established where public access is denied to both unauthorized employees and customers. Such areas can be as follows:

1. Offices where financial data are compiled or sensitive information is processed
2. Communication facilities, i.e., telephone wires, cables, and switching boxes
3. Warehouses where inventory is kept
4. Power stations, transformers, and master valve and switch spaces
5. Open storage areas and yards
6. Intrusion detection systems-monitoring spaces
7. Central storage spaces for keys and locks
8. Cash storage spaces
9. Negotiable instrument storage spaces

## 27.15 Security Measures

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Restricted areas should include measures that exclude or require the following:

1. A clearly defined area or perimeter. The perimeter may be a fence, exterior walls, building, or a space within a building.
2. A personnel identification and control system. This may include an access list, entry–departure logs, and identification badges. For small companies, the issuance of keys to only authorized personnel may be adequate. Larger companies may require more sophisticated systems.
3. Ingress and egress controlled by guards or personnel within the restricted area.
4. Admission allowed only to people whose duties require access and who have been granted authorization.

Signs should be posted that tell people the area is restricted or say “authorized personnel only.”

### 27.15.1 Key and Lock Controls

Businesses should establish a strict key and lock control program that is managed and supervised by the security manager. It should include controls over all keys, locks, padlocks, and locking devices used to protect or secure restricted areas, perimeters, facilities, critical assets, and sensitive materials and supplies. The program should not include keys, locks, and padlocks for convenience, privacy, or personnel use. Examples are employee lockers, employee restrooms, and employee desks. Store managers, department heads, branch managers, etc., should be responsible for all keys controlled in their respective spaces and areas. Security locks, padlocks, and lock cores should be rotated from one location to another or changed at least once a year to guard against the use of illegally duplicated keys. Regular maintenance should be done to guard against malfunction because of dirt, corrosion, and wear. Keys for security locks and padlocks should be issued only to those with a need approved by management or the security manager. Convenience or status is not a sufficient criterion for issuance of a security key. A central key room should be established. Also, each key custodian and subcustodian must institute a system showing keys on hand, keys issued, to whom, date and time the keys were issued and returned, and the signatures of persons drawing or returning security keys. Continuous accountability of keys is required at all times. When the door, gate, or other equipment that the padlock is intended to secure is open or operable, the padlock should be locked into the staple, fence fabric, or other nearby securing point to preclude the switching of the padlock to facilitate surreptitious entry by a thief or others. Inactive or infrequently used gates and doors should be locked and have seals affixed.

### 27.15.2 Parking

As a general rule, to prevent property losses, employees should not be permitted to park immediately adjacent to work spaces. Privately owned vehicles, except those driven by disabled employees, should not be parked within 100 feet of doorways leading into or from buildings primarily used for the manufacturing, repair, rework, storage, handling, packaging, or shipping of inventory, materials, and supplies. Businesses that have many employ-

ees, more than a guard can recognize, usually 50 or more, should have employee parking permits issued to personnel to restrict parking. A system should be in place to collect parking permits when employees leave employment.

### **27.15.3 Protective Lighting**

Protective lighting provides a means of continuing, during hours of darkness, a degree of security approaching that which is maintained during daylight hours. It has considerable value as a deterrent to thieves and vandals and makes the job for them more difficult. Requirements for protective lighting will depend on the situation. The mix between energy conservation and effective security must be carefully studied in each situation. The overall goal is to provide the proper environment to perform duties, prevent illegal entry, detect intruders, and inspect unusual or suspicious activities. The following basic principles apply to help ensure protective lighting effectiveness:

1. Provide adequate illumination to discourage or detect illegal attempts to enter restricted areas and to reveal the presence of unauthorized persons within such areas.
2. Avoid glare, which handicaps security personnel or is objectionable to traffic or occupants of adjacent properties.
3. Locate light sources so that illumination is directed toward likely intruder avenues of approach.
4. Illuminate areas shadowed by structures within or adjacent to restricted areas.
5. Design the system to provide overlapping light distribution; design equipment to resist the effects of environmental conditions; locate all components of the system to provide maximum protection against intentional damage.
6. Avoid drawing unwanted attention to restricted areas.

### **27.15.4 Intrusion Detection Systems**

An intrusion detection system (IDS) should be an essential element of any in-depth security program. IDS consists of sensors capable of detecting one or more types of phenomena, signal media, annunciators, and energy sources for signaling the entry or attempted entry into the area protected by the system. IDS is designed to detect, not prevent, actual or attempted penetrations. Therefore, IDS is useless unless it is supported by a prompt security force response when the system is activated.

#### **27.15.4.1 IDS Purpose**

IDS is used to accomplish one or more of the following:

1. Permit more economical and efficient use of security personnel through the employment of mobile responding guard forces or local law enforcement
2. Provide additional controls at critical areas
3. Substitute for other physical security measures, which cannot be used because of safety regulations, operational requirements, building layout, cost, or similar reasons
4. Provide insurance against human failure or error

5. Enhance security force capability to detect and defeat intruders
6. Provide the earliest practical warning to security forces of any attempted penetration of protected areas

#### **27.15.4.2 IDS Determination Factors**

The following factors must be considered in determining the feasibility and necessity of installing IDS equipment:

1. The type of business operation or facility
2. Criticality of the operation or facility
3. Threat to the operation or facility
4. Location of the operation or facility and the location of the areas within each facility
5. Accessibility to intruders
6. Availability of other forms of protection
7. Initial and recurring cost of the system
8. Personnel and money savings over expected life of the system
9. Construction of the building or facility
10. Hours of operation of the facility
11. Availability of a security force and expected response time to an alarm condition

#### **27.15.4.3 Types of Systems**

There are basically four types of IDSs:

1. **Local alarm.** The protective circuits and alarm devices actuate a visual or audible signal in the immediate vicinity of the protected area, usually on the exterior or interior of the building. The alarm transmission/communication lines do not leave the building. Response is by local security forces that may be in the area when the alarm is sounded. Otherwise, the security force will only know of the alarm if reported by a passerby or during routine checks. The disadvantage of this type of system is that intruders know exactly when the alarm is activated and, in most cases, can easily elude capture. This type of system should be used only when guards or workers are always in close proximity to the audible or visual alarm and are able to respond to it.
2. **Central station.** The operation of alarm devices and electrical circuits is automatically signaled to, recorded in, maintained, and supervised from a central station, owned or managed either in house or by a commercial firm that has trained guards and operators in attendance at all times. These personnel monitor the signals of the system and provide the response force to any unauthorized entry into the protected area. Connection of alarm equipment to the central station is usually over telephone lines.
3. **Police connection.** The alarm devices and electrical circuits are connected via telephone lines to a monitoring unit located in nearby police stations. An agreement with the local police department must be arranged prior to establishment of this type of system.
4. **Proprietary IDS station.** This system is similar to a central station operation, except that the IDS monitoring/recording equipment for all IDSs at the installation is located within a constantly manned security force communications center

maintained or owned by a commercial company. The security force operates and responds to all IDS activations. Connection of the alarm equipment to the monitoring room can be over telephone lines or by separate cable installed by the equipment company. This is the preferred IDS monitoring system for medium to large organizations.

#### **27.15.4.4 Sensor Systems**

Sensor systems are divided into two areas based on environmental use:

1. **Exterior sensors.** Exterior intrusion detection devices should be selected for the best performance under such prevailing local environmental conditions as soil, topography, weather, and any other factors that could adversely affect device performance or increase its false alarm rate. The detecting devices are designed for outside installation and are usually used in conjunction with barriers such as fences. Commonly used sensors include those that detect light beam interruption, motion, pressure, vibration, magnetic field distortions, and seismic disturbances or combinations of these.
2. **Interior sensors.** Interior intrusion detection devices should be selected and installed to provide the best reliable information to security personnel in the shortest possible time. The devices are primarily designed to operate within an environmentally protected area to overcome security weaknesses in buildings, rooms, etc. Commonly used devices include those that detect motion, light beam interruption, sound, pressure, vibration, capacitance change, heat, magnetic field change, penetration, and the breaking of an electrical circuit.

#### **27.15.4.5 Data/Signal Transmission System**

This system integrates the sensors and the control/monitoring capabilities into a complete functioning IDS. The transmission medium is used to send control signals and data between all sensors, control points, and annunciator display panels. It may be wire landlines, radio frequency, link, or a combination of these. This vital system is probably the weakest and most vulnerable of all the IDSs and requires protection.

#### **27.15.4.6 Control and Display System**

This system provides equipment for central operational control and monitoring of the IDS. Through this equipment, the security personnel are instantly alerted to the status of any protected area. This system should be located in a separate area closed off from public view. Zone numbers should be used to designate alarmed spaces or items, i.e., buildings, room numbers, and inventory items.

#### **27.15.4.7 Power System**

Normal power to operate an IDS is usually derived from local electrical power, e.g., the electric company. The importance of continuous function for an IDS cannot be overstated. Therefore, each IDS should have an emergency backup source of power in the event of a power failure, to ensure the continuous operation of the system. The backup power source usually consists of batteries, which should be of a rechargeable type. Power supplies should be arranged so that batteries are maintained fully charged at all times when power is



available. The system should automatically transfer from AC to battery power whenever the former fails, and return to AC power upon restoration of that power.

#### **27.15.4.8 Maintenance**

Proper maintenance of an IDS is imperative. Systems that are not properly maintained may either fail to detect intrusion or yield a high number of bogus alarms, commonly referred to as false or nuisance alarms. Systems that generate frequent false or nuisance alarms lose their credibility and demoralize security personnel to the point where alarm activations are ignored. The contracting company should develop procedures to ensure that only appropriately cleared personnel install, inspect, or maintain the IDS.

### **27.16 Security Audits**

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Each business organization should have a program to assess the degree of security within the organization. Security assessments should be done at least once a year to ensure compliance by management and employees. The assessment should cover compliance with security measures, loss prevention programs, and crisis management. Fire drills should be conducted periodically. Disaster plans should be reviewed. Management and employees should be trained or at least informed each year. Loss prevention and disaster plans should be evaluated each year.

### **27.17 Security Checklist**

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The purpose of the security checklist is to provide a business organization with guidelines for evaluating existing security measures. It is not intended to be all-inclusive. It is more appropriate for larger organizations, but many questions are relevant to smaller businesses as well.

#### **Business Security Checklist**

1. Is there a security manager?
2. Does the organization have a security plan?
3. Does the security plan contain instructions for the following?
  - a. Fire
  - b. Natural disasters
  - c. Disturbances
  - d. Sabotage
  - e. Bomb threats
  - f. Theft
  - g. Robberies
4. Does the security plan include procedures for the following?
  - a. Evaluating and handling threatening messages
  - b. Evacuation of personnel and customers
  - c. Suspected bomb found on premises
  - d. Reporting robberies

- e. Reporting internal theft
5. Does the organization have a counterespionage program?
6. Are security plans reviewed annually?
7. Has the security manager established a liaison with local law and fire authorities?
8. Are the basic security measures for exclusion areas in effect?
9. Are security measures in effect to protect the following?
  - a. Electric power supplies and transmission
  - b. Communication centers/equipment
  - c. Computer and financial data and files
10. Is there a key and lock custodian?
11. Does the key and lock control program include the following?
  - a. A key control register
  - b. An inventory of keys
12. Is the present security force strength and composition commensurate with the degree of security protection required?
13. Does the security manager inspect and brief personnel on a daily basis?
14. Does the organization have a crisis plan in effect?
15. Are security personnel available and trained in procedures to help police and fire authorities?
16. Is a pass or badge identification system used to identify all personnel in the confines of restricted areas?
17. Does the identification system provide the desired degree of security?
18. Does the identification system provide procedures for the following?
  - a. Protection for the badges and passes
  - b. Designation for areas requiring special control measures
  - c. Control of the pass or badges issued
  - d. Mechanics of identification upon entering and leaving each restricted area, as applied to both employees and visitors
  - e. Details of where, when, and how badges should be worn
  - f. Procedures to be followed in case of loss or damage to identification media
  - g. Procedures for recovery and invalidation
19. If a badge system is used for any security area, does the system provide for the following?
  - a. Comparison of badge, pass, and personnel
  - b. Physical exchange of pass/badge at time of entrance/exit
  - c. Accounting for each badge or pass
  - d. Location and verification of personnel remaining within the security area at the end of normal working hours
  - e. Security of badges and passes not in use
20. Do guards at control points compare badges to bearers, upon both entry and exit?
21. Is supervision of the personnel identification and control system adequate at all levels?
22. Are badges and serial numbers recorded and controlled by rigid accountability procedures?
23. Are lost badges replaced with badges bearing different serial numbers?
24. Have procedures been established that provide for issuance of temporary badges for individuals who have forgotten their permanent badges?

25. Are temporary badges used?
26. Are lists of lost badges posted at guard control points?
27. Are badges of such design and appearance as to enable guards and other personnel to recognize quickly and positively the authorizations and limitations applicable to the bearers?
28. Are procedures in existence to ensure the return of identification badges upon termination of employment or assignment?
29. Are special badges issued to contractor employees working within security areas?
30. Are all phases of the personnel identification and control system under the supervision and control of the security manager?
31. Have effective visitor escort procedures been established?
32. What controls are employed to control visitor movements while in restricted areas?
33. Are visitors required to display identification media conspicuously on outer garments at all times while within restricted areas?
34. When visitors depart restricted areas, are they required to turn in identification badges and is the departure time in each case recorded in the visitor register?
35. Are visitors who indicate an intention to return at a later time permitted to retain identification badges?
36. Are permanent records of visits maintained? By whom?
37. What measures are employed, other than the issuance of identification badges, to control the movement of contractor personnel working within restricted areas?
38. Have written procedures been issued and authorized for the registration of privately owned vehicles on business premises?
39. What type of pass is used and where is it affixed/located within/on the vehicle?
40. Are temporary passes issued to visitor vehicles?
41. Are automobiles allowed to be parked within restricted areas?
42. Are parking areas within restricted areas located away from restricted areas?
43. Does a fence or other type of physical barrier define the parking perimeter and all restricted areas?
44. Are openings such as culverts, tunnels, manholes for sewers and utility access, and sidewalk elevators that permit access to the restricted area properly secured?
45. Are gates and other entrances that are not actively used locked and equipped with seals and frequently inspected by other personnel?
46. Are locks rotated annually?
47. Are all normally used pedestrian and vehicular gates and other entrances effectively and adequately lighted to ensure the following?
  - a. Proper identification of individuals and examination of credentials
  - b. Interior of vehicles can be observed
  - c. That glare from luminaries does not interfere with the guard's vision
48. Are appropriate signs setting forth the provisions of entry conspicuously posted at all entrances?
49. Are "No Trespassing" signs posted on or adjacent to barriers at such intervals that at least one sign is visible at any approach to a barrier during daylight hours?
50. Are lumber, boxes, or other extraneous material not allowed to be stacked against or adjacent to the barriers or doors?
51. Do guards patrol perimeter areas?
52. Are any perimeters protected by intrusion detection systems?

53. Does any relocated function, newly designated security area, physical expansion, or other factor indicate necessity for installation of additional barriers or additional lighting?
54. Is the perimeter of the installation and security area provided with adequate lighting?
55. Does protective lighting meet adequate intensity requirements?
56. Are the cones of illumination from lamps directed downward and away from guard personnel?
57. Is perimeter lighting utilized so that guards remain in comparative darkness?
58. Are lights checked for proper operation prior to darkness?
59. Are repairs to lights and replacement of inoperative lamps effected immediately?
60. Is additional lighting provided for active doorways and points of possible intrusion?
61. Does the operation have a dependable source of power for its lighting system?
62. Does the operation have a dependable auxiliary source of power?
63. Is the power supply for the protective lighting system protected? How?
64. Is there a provision for standby or emergency protective lighting?
65. Is the standby or emergency equipment tested frequently?
66. Can the emergency equipment be rapidly switched into operation when needed?
67. Is wiring tested and inspected periodically to ensure proper operation?
68. Is parallel circuitry used in the wiring?
69. Are multiple circuits used?
70. Is closed loop used in multiple circuits?
71. Is wiring for protective lighting properly run?
  - a. Is it in tamper-resistant conduit?
  - b. Is it installed underground?
  - c. If aboveground, is it high enough to preclude the possibility of tampering?
72. Are switches and controls properly located, controlled, and protected?
73. Is the protective lighting system designed and located so that repair can be made rapidly in an emergency?
74. Are materials and equipment in shipping and storage areas properly arranged to provide adequate lighting?
75. Does the organization employ any intrusion detection systems?
76. Does the IDS, where required or used, meet the following minimum requirements?
  - a. Balanced magnetic switches installed on all perimeter doors
  - b. Sensors attached to windows and doors
  - c. Sensors attached to structural sections that do not provide penetration resistance roughly equivalent to that required for the basic structure
  - d. Signals monitored at one central point and the guard force response initiated from that point
  - e. All sensor equipment, doors, drawers, and removable panels secured with key locks or screws and equipped with tamper switches
  - f. Power supplies protected against overload by fuses or circuit breakers
  - g. Power supplies protected against voltage transients
  - h. Safety hazards identified and controlled to preclude personnel exposure
  - i. IDS components meet electromagnetic interference/electromagnetic compatibility requirements

- j. IDS components meet the spurious radiation requirements set by the Federal Communications Commission
- 77. Do properly trained security alert teams back up the system?
- 78. Is the alarm system for active areas or structures placed in access mode during normal working hours?
- 79. Is the system tested prior to activation?
- 80. Is the system inspected regularly?
- 81. Is the system weatherproof?
- 82. Is an alternate or independent source of power available for use on the system in the event of a power failure?
- 83. Is the emergency power source designed to cut in and operate automatically when normal power goes down?
- 84. Do trained and properly cleared personnel properly maintain the IDS?
- 85. Are frequent tests conducted to determine the adequacy and promptness of response to alarm signals?
- 86. Are records kept of all alarm signals received, to include time, date, location, action taken, and cause for alarm?
- 87. How frequent are nuisance alarms and what action is taken to reduce the number?
- 88. Does the organization have a current security education program?
- 89. Are all newly assigned personnel provided security indoctrination?
- 90. Is security education training conducted for all personnel at least annually?
- 91. Have security personnel been trained in procedures necessary for the implementation of emergency and disaster plans for their organization?
- 92. Are security personnel qualified in assigned weapons if required?
- 93. Have armed security personnel received instruction in the use of deadly force?
- 94. Does the security force have its own communication system with direct lines between security and restricted areas?
- 95. Does the security communication system provide the security personnel with the means to rapidly apprise their superiors of problem situations?
- 96. Does the organization use a security dog program?
- 97. Have direct communications with local municipal fire and police headquarters been established?

## 27.18 Self-Protection

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Many assaults take place at either the workplace or home. Assaults in parking lots of shopping centers, office buildings, plants, etc., are becoming more prevalent. Some tips for self-protection are listed below:

1. Walk with someone. Arrange to meet other employees when entering or leaving the business premises. If security guards are available, you should have them escort you. This should be done when it is dark or at odd hours.
2. Stay in well-lit areas, e.g., near curbs, lighted entrances, light poles, etc. Avoid alleys, unlighted entrances, deserted stairwells, dark rooms, etc. Avoid walking near blind spots such as columns or between cars.

3. Stay near other people or crowds. Avoid shortcuts through parks, vacant lots, or deserted places.
4. Hold a purse close under your arm with latch in, not dangling. Long straps should be around the shoulder or neck. Never set a purse or wallet on store counters, in supermarket baskets, or on car or bus seats.
5. When shopping, do not put money or credit and debit cards on counter. Put it in the hand of the store clerk. Do not flash large amounts of money.
6. Pay attention to your surroundings. Keep alert. Pay attention to anything that is unusual, e.g., people and vehicles.
7. If a driver stops to ask you questions, avoid getting near the car. Never reach in or get in a stranger's vehicle.
8. If you feel that you are being followed, then be prepared to take some action, e.g., run. If someone is following you on foot, cross the street, change direction, or vary your pace. Proceed to a lighted store or home and call the police or relative or friend to pick you up. The police will usually escort you home. If someone is following you in a car, turn around and walk in the other direction. Record the license number and call the police.
9. When you go to your vehicle, have your key ready and check the front and back seats before entering.
10. If you have a dog, particularly of medium or large size, and you go to a park or other recreational area, or the neighborhood store, you should take the dog with you. The presence of a medium or large dog deters criminals even if the dog has a gentle personality.
11. If attacked, scream as loud as you can. It may scare the attacker away. Otherwise, kick him or her in the groin or on the foot and foreleg. Doing this will give you a chance to escape.

## 27.19 Summary

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Physical security measures help eliminate the opportunity for employees and customers to remove inventory, assets, and supplies from a business organization's premises. Therefore, they cannot be overlooked. For small businesses, the costs of security measures can be onerous since businesses have to balance their needs and benefits to the costs. Various electronic and other devices are making rapid advances in technology. These new and improved systems are becoming cheaper. Many businesses, regardless of size, are using various new systems. One system attaches labels that will set off an alarm if the item is not scanned at the checkout counter. In another system, clothing stores attach dye devices that will explode over the clothing if the customer removes the merchandise from the store without it being scanned at the checkout counter. Each business organization will have to evaluate the various security measures to meet its particular requirements.





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## 28.1 Introduction

Law enforcement officers may be required to execute search warrants in order to obtain evidence. Subjects of an investigation will usually keep some inculpatory evidence in their possession, at either their residence or business premises. A search warrant authorizes limited intrusion into an area where there is reasonable expectation of privacy to search and seize certain specified evidence of a crime based on probable cause. A judge or magistrate is usually willing to issue a search warrant when information is provided by a reliable source. Fraud examiners can be used as a reliable source when they uncover evidence that other financial records are available at some identified location. Generally, evidence obtained by a defective search warrant is no longer suppressed if the law enforcement officers relied upon those defective warrants and acted in good faith. However, search warrants may cause many motions to be filed, which can tie up a case. Also, they can trigger Fourth Amendment considerations such as staleness, overbreadth, and other issues.

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## 28.2 Fourth Amendment

The Fourth Amendment to the U.S. Constitution, adopted in 1791, states, “The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no warrants shall issue, but upon probable cause, supported by oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized.”

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## 28.3 Criminal Procedure

Rule 41 of the Federal Rules of Criminal Procedure contains the procedures for obtaining a warrant:

Rule 41(a) provides for the issuance of a warrant by a federal magistrate or a judge of a state court of record within the district where the property or person sought



is located, upon request by a federal law enforcement officer or an attorney for the government.

- Rule 41(b) provides for issuance of a warrant to seize (1) property that constitutes evidence of the commission of a crime; or (2) contraband, the fruits of a crime, or things otherwise criminally possessed; or (3) property designed or intended to be used as an instrumentality of a crime; or (4) people, when there is probable cause for their arrest.
- Rule 41(c) provides for issuance of a warrant based on a sworn affidavit, which establishes the grounds for issuance of the warrant. If the federal magistrate is satisfied that the grounds for the application exist or that there is probable cause to believe that they exist and approves the warrant, then the officer has 10 days to execute the warrant. The search should be performed between 6:00 A.M. and 10:00 P.M., or the officer should be able to show cause why this cannot be done.
- Rule 41(d) requires the officer taking the property to provide a copy of the warrant and a receipt for the property taken. The return shall be made promptly and accompanied by a written inventory of the property taken to the magistrate.
- Rule 41(e) provides that an aggrieved person of an unlawful search and seizure may move the district court for the return of said property.
- Rule 41(f) provides that a motion to suppress evidence may be made in the court of the district of trial as provided by Rule 12.

## 28.4 Purpose

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A search warrant authorizes a limited intrusion into an area protected by the Fourth Amendment. A neutral and detached magistrate may, upon a finding of probable cause, issue a search warrant. The search warrant must specify with particularity the area or premises to be searched and the persons or things to be seized. This requirement of particularity prevents any kinds of exploratory searches. The premises to be searched must be sufficiently described to enable the executing officers to ascertain and identify it with reasonable certainty. Also, the persons or things to be seized must be specifically identified without leaving any doubt. The test is whether the officer can identify the item to be seized.

## 28.5 Privacy Expectation

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The Supreme Court has adopted a two-pronged test in determining whether privacy interests are protected: (1) the individual must show a subjective expectation of privacy, and (2) the privacy expectation must be generally recognized as reasonable. The courts have found reasonable expectation of privacy for a person's home, a public employee's desk or file cabinets in the office, a person's luggage, and on his or her person. However, the courts have found no reasonable expectation of privacy in a warrantless installation of a pen register on a telephone or goods displayed in a store.

## 28.6 Probable Cause

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The Fourth Amendment requires a finding of probable cause before the issuance of a valid search warrant. This protects an individual's expectation of privacy. Probable cause has been defined as facts and circumstances that will cause a prudent person to believe that an offense has been committed and that seizable property can be found at the place or on the person to be searched. Law enforcement has probable cause to conduct a search if a reasonably prudent officer, based on the facts and circumstances known by the officer, would be justified in concluding that the items sought are connected with criminal activities and that they will be found in the area to be searched.

While proof beyond a reasonable doubt is not required, some factual showing is required and not suppositions or speculations. The following have been found to be insufficient in establishing probable cause:

- Mere conclusory statement or an officer's mere notification of bare conclusions from other(s) (*Illinois v. Gates*, 462 U.S. 213)
- An officer's mere suspicion of criminal activity (*Brinegar v. United States*, 338 U.S. 175)
- Mere association with known or suspected criminals (*Ybarra v. Illinois*, 444 U.S. 85)
- An individual's mere presence at a given location (*United States v. Butts*, 704 F.2d 70)

The conclusions by an affiant may be included in a search warrant affidavit and considered in determining whether there is probable cause. Factual conclusions are a normal, necessary, and perfectly acceptable part of an affidavit. However, such conclusions must be drawn from facts contained within the affidavit and cannot be premised on the conclusory statements of others.

## 28.7 Magistrate

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Facts justifying probable cause to search must be subjected to the scrutiny of a neutral and detached magistrate. As the Supreme Court stated in *Steagald v. United States*, 451 U.S. 204:

The placement of this checkpoint between the government and the citizen implicitly acknowledges that an officer engaged in the often competitive enterprise of ferreting out crime may lack sufficient objectivity to weigh correctly the strength of the evidence against the individual's interests in protecting his own liberty.

An officer, in seeking a search warrant, must present sufficient facts in the affidavit to enable a magistrate to make an independent determination as to the existence of probable cause. Probable cause may be based on hearsay information and need not reflect direct personal observations. The magistrate must be informed of the surrounding circumstances. The Supreme Court has strongly expressed preference for using search warrants because it imposes an orderly procedure and reduces the risks inherent in police actions.

## 28.8 Staleness

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The amount of delay that will make information stale will depend on the facts of the case. Staleness cannot be resolved by reference to the number of days between the facts relied upon and the time the warrant is issued. If the items still have a reasonable chance of being present, then the warrant can be issued even after a lengthy time. The staleness test is not designed to create an arbitrary time limitation. The test is whether the affidavit sufficiently establishes a fair probability that contraband or evidence of a crime would be found on the premises. The facts and circumstances of the case, including the nature of the unlawful activity, the length of time, and the nature of the property to be seized, must be considered.

## 28.9 Probable Cause Based on Informants

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Probable cause may be based on hearsay evidence whether in whole or in part (Federal Rules of Evidence (FRE) Rule 41(c)(1)). Prior to 1983, the court had a two-pronged test to determine an informant's reliability: (1) the facts that the informant provided must show the informant is credible and reliable, and (2) some of the information can be verified. In *Illinois v. Gates* (462 U.S. 213), the Supreme Court abandoned the two-pronged test and reinstated the totality-of-the-circumstance test for probable cause determinations. Elements of knowledge, reliability, and veracity were relevant considerations in the totality of circumstances. A deficiency in one element could be compensated for by a strong showing in another, or by some other indication of reliability. The court reiterated the standard of review. A magistrate should review the evidence on the whole for substantial basis. It rejected any after-the-fact review by a magistrate for probable cause determination. One way to establish credibility and reliability is by having two informants independently corroborate each other's statements. By telling consistent, yet independent stories, the informants provided cross-corroboration. This enhances the reliability on the application for a warrant.

## 28.10 Particularity

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The Fourth Amendment requires that a search warrant particularly describe (1) the place to be searched and (2) the persons or things to be seized. The aim is to protect the privacy of citizens against general rummaging through their possessions. General exploratory searches are forbidden. The Supreme Court has interpreted this requirement to mean that the description of the place to be searched be such that the officer can easily ascertain and identify the place intended. Also, the Fourth Amendment requires particularity as to items to be seized. The purpose is to prevent general seizure of property. Only items listed in a warrant can be seized. In *Andresen v. Maryland* (427 U.S. 463) the court expounded searches and seizures of personal or business records. It stated:

There are grave dangers inherent in executing a warrant authorizing a search and seizure of a person's papers that are not necessarily present in executing a warrant to search for physical objects whose relevance is more easily ascertainable. In searches for papers, it is certain that some innocuous documents will

be examined, at least cursorily, in order to determine whether they are, in fact, among those papers authorized to be seized. In this kind of search, responsible officials, including judicial officials, must take care to assure that they are conducted in a manner that minimizes unwarranted intrusions upon privacy.

The Ninth Circuit has suggested that an affidavit should always be incorporated into the warrant. The affidavit can be used to provide further guidance to seizing agents and save an otherwise deficient search warrant. Generally, it is not a search warrant if it contains standards that guide officers in avoiding seizure of items not relevant to the case. The Ninth Circuit overturned a warrant because it was not specific enough. The warrant should have described particular items found in the possession of loan sharks and bookmakers, such as “pay and collection sheets, lists of loan customers, loan accounts and telephone numbers, line sheets, bet slips, tally sheets, and bottom sheets.” A search warrant is valid if it fully describes the alleged criminal activities in connection with which items were sought. In *United States v. Stubbs* (873 F.2d 210) the court decided the particularity issue by focusing on:

1. Whether probable cause existed to seize all items of a particular type described in the warrant
2. Whether the warrant set out objective standards by which officers could differentiate items subject to seizure from those that are not
3. Whether the government was able to describe the items more particularly in light of the information available to it at the time the warrant was issued

The Ninth Circuit suppressed evidence in the *Stubbs* case because the warrant that authorized the seizure of all financial records was too general. The warrant should have been more specific since there were two former employees cooperating in the investigation who knew where various documents were stored.

## 28.11 Places to Be Searched

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The Fourth Amendment requires that the warrant particularly describe the place to be searched. The Fourth Amendment does not require legal descriptions. It points to a definitely ascertainable place so as to exclude all others. The test for determining the sufficiency of a description is:

1. Whether the place is described sufficiently enough to enable an officer to locate and identify the premises with reasonable effort
2. Whether there is reasonable probability that other premises might be mistakenly searched

There have been situations where law enforcement has searched the wrong place, even when the warrant was stated correctly. The search of an entire apartment building where probable cause was limited to only one apartment was not permitted. The courts have ruled that the name of an apartment complex or business enterprise will prevail over a

street address. Also, the name of the occupant with a description of the premises will prevail over the stated apartment number or floor.

## **28.12 Items to Be Seized**

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A search warrant must describe the items to be seized. The warrant must be worded in such a way as to describe only those items directly related to the crime under investigation. It must be drafted so as to prevent indiscriminate seizing of both relevant and irrelevant evidence. The general rule is to describe with as much specificity as possible.

## **28.13 Generic Description**

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When the precise identity of items cannot be ascertained, then the use of a generic class of items will suffice. Some courts have indicated that a general description of property will be acceptable provided the circumstances and nature of the activity under investigation are identified. The use of a generic term or general description is only acceptable when a more specific description of the items to be seized is not available. Failure to use specificity when information is available will invalidate a general description in a warrant. When there is probable cause to believe that the premises to be searched contains a class of generic items, a portion of which may be contraband, then a search warrant may direct inspection of the entire class. There must be articulated standards for the officers to follow in distinguishing between legal and illegal property. These standards may be contained in the search warrant or the accompanying affidavit. To determine that a search warrant containing a generic description satisfies the specificity requirement, see if the warrant:

1. Establishes that there is a reason to believe that a large collection of similar items, i.e., evidence of a crime, is present on the premises to be searched
2. Explains the methods to be used by officers to differentiate the evidence of a crime from items that are not

## **28.14 Permeated-with-Fraud Concept**

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When a business operates in a way that every transaction is potential evidence of fraud, the permeated-with-fraud concept allows seizure of all business records. If the whole business is a fraud, a warrant may properly permit the seizure of everything the officer finds. To establish that a business was permeated with fraud, a pattern of criminal conduct must exist that shows the existence of a plan, scheme, or artifice. When investigating the business practices, the investigation should not focus on just a small segment of operations, but should be based on a major portion of the business operations. The permeated-with-fraud concept does not allow for wholesale seizure of all books and records of a business. The search warrant or affidavit must accurately describe those books and records that relate to the pervasive scheme to defraud.

## 28.15 Plain-View Doctrine

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Law enforcement officers sometimes find other articles that they desire to seize because of their apparent connection to some criminal activity. The plain-view doctrine provides that a law enforcement officer may seize evidence when

- The law enforcement officer is lawfully on the premises by virtue of:
  - Searches pursuant to warrants issued for other purposes,
  - Searches pursuant to exceptions to the warrant requirement, or
  - The performance of general police duties;
- The law enforcement officer inadvertently comes upon the item;
- It is immediately apparent that the item is incriminating; and
- It is incriminating evidence.

The plain-view doctrine does not allow the seizure of material when the incriminating or evidentiary character of the material becomes known only after close inspection. Also, it does not allow law enforcement officers to examine items to expand from observation into a general exploratory search. Probable cause is required to invoke the plain-view doctrine as it applies to seizures.

### 28.15.1 Inadvertent Discovery

Inadvertence is a common element of most plain-view seizures. It is not a necessary element. However, if police failed to particularize evidence in advance with the expectation that the evidence exists, then the warrant lacks probable cause for seizure of such evidence. The Second Circuit concluded that where proof indicated that the police conducted a thorough investigation of a crime and the means to prove it, and the search is conducted in a manner reasonable in duration and intensity, the property seized may be found to be inadvertently discovered in plain view.

### 28.15.2 Immediately Apparent Requirement

The incriminating nature of the evidence must be immediately apparent. The immediately apparent requirement ensures that the police will not use this method as a way to justify exploratory searches. Also, the police must be aware of some facts and circumstances that can justify suspicion that items are fruits, instruments, or evidence of crime. The First Circuit said that the plain-view doctrine allowed evidence discovered in plain view to be lawfully seized even though the police were not originally authorized to search for it when:

- The officer's presence at the point of discovery is lawful
- Discovery of seized items is inadvertent
- The evidentiary value of the item is immediately apparent to the searchers

## 28.16 Affidavit Inaccuracies

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A warrant may be invalidated if the supporting affidavit is inaccurate. The Supreme Court in *Frank v. Delaware* (438 U.S. 154) identified some circumstances that could mandate an

evidentiary hearing. If a defendant challenges the truthfulness of statements contained in the affidavit, then the defendant is entitled to a “Frank” hearing. The defendant must show in a Frank hearing that (1) the false statement was knowingly and intentionally made, or with a reckless regard for the truth, and (2) the allegedly false statement is necessary to the magistrate’s finding of probable cause.

The court must void the warrant if the defendant proves the allegations by a preponderance of the evidence and there is no support of probable cause.

## **28.17 Exclusionary Rule**

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The exclusionary rule prohibits introduction into evidence any material seized during an illegal search. This rule also prohibits any derivative evidence that is the product of the primary evidence or is acquired as an indirect result of an illegal search. In *United States v. Leon* (468 U.S. 897) the Supreme Court modified the exclusionary rule for search warrants that were obtained in “good faith.” The court did not want to penalize police who thought that they were acting properly in obtaining a warrant, even though the warrant failed for some technicality at a later date. The court provided the following good faith factors:

- The warrants were facially valid.
- The warrants were properly approved by a neutral and detached judicial officer.
- The police relied on the magistrate’s probable cause determination.
- The officer’s reliance was objectively reasonable.

The evidence will not be suppressed if the exclusionary rule is not applied. The exclusionary rule is a judicial remedy that is designed to deter police misconduct. The appropriateness of excluding evidence must be evaluated by weighing the costs and benefits of suppression. Suppression is not appropriate if the police acted in good faith that the warrant was valid and authorized their conduct. The court defined good faith as the lack of disregard or conscious indifference to Rule 41.

### **28.17.1 Inevitable Discovery Exception**

The Supreme Court in *Nix v. Williams* (467 U.S. 431) adopted the inevitable discovery doctrine as an exception to the exclusionary rule. Evidence discovered as a result of violations of Sixth Amendment rights can be admitted at trial if the prosecution can establish, by a preponderance of the evidence, that such evidence ultimately and inevitably would have been discovered by lawful means.

### **28.17.2 Independent Source Rule**

The independent source rule is another exception to the exclusionary rule. It provides that evidence will not be suppressed if the government obtains the evidence from an independent and legal source.

## 28.18 Intermingling of Documents

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Only specific and listed items in a search warrant may be seized. There are occasions where documents are so intermingled that they cannot be feasibly sorted on site. The wholesale seizure for later detailed examination of records not described in a warrant is prohibited. All items in a set of files may be inspected during a search, provided that sufficient guidelines for identifying the documents sought are provided in the search warrant and are followed by the officers conducting the search. Where documents are so intermingled that they cannot be sorted on site, the court has suggested that police should seal and hold the documents pending approval by a magistrate of a further search. If there is a need to transport the documents, then police should apply for specific authorization for large-scale removal of material to a site more suitable for searching.

## 28.19 Effect of Unauthorized Seizure on Valid Search

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When a search is conducted and items are seized that are not specifically described in the warrant, the remedy by the court is to exclude the items that are improperly taken. The court fulfills three purposes in the following ways:

1. It erects a deterrent to illegal searches.
2. It prohibits the government from benefiting from its own wrongdoing by not using the illegally seized evidence to convict.
3. By removing the illegally seized items, it precludes itself from serving as an accomplice in the violation of the Constitution.

It is permissible for federal agents to take along local law enforcement officers when executing search warrants. However, the local law enforcement officers must abide by the specifics and limitations of the search warrant.

## 28.20 Conforming Warrants to Technology

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The search and seizure of data contained in computers and other electronic media raise various issues that must be considered. Information in computers is not evident like paper records, but must be generated by particular commands. Also, the data contained in computers may not be in readable form and may be intermingled with information that is not relevant. When it comes to computers, the question of what can be searched and seized arises. Also, the Electronic Communications Privacy Act (ECPA) imposes various kinds of restrictions and obligations on law enforcement agencies. Some of the issues that relate to computer search warrants are as follows:

- Establishing probable cause
- Execution or access
- Segregation issues
- ECPA issues



- Privacy Protection Act issues
- Subpoenas for computer records

Probable cause does not authorize police to search any computer found on the premises. Police must describe their beliefs that the computer was used for the creation or storage of financial records. The officer must determine the computer's role in the offense. Key questions are:

- Is there probable cause to seize hardware?
- Is there probable cause to seize software?
- Is there probable cause to seize data?

In developing probable cause, the investigator should evaluate the record system in operation and determine if there are any network and backup systems. Additional considerations are:

- Functions of the computer
- Records processed and stored on the system
- Programs used
- Sophistication of system by users
- Type of storage facilities
- Media used

The seizing agent should describe the information and items to be seized as explicitly as possible in the affidavit. The seizing agent should ask for express authority to remove any hardware in order to conduct an off-site search. The agent should mention any manuals or instructions for the computer system. A "no-knock warrant" should be requested if destruction is a concern. Probable cause to seize a computer does not necessarily mean the entire computer system, i.e., all peripheral devices. The search warrant for computers needs to describe the computer system and the information contained therein in detail. For a computer not under the control of the suspect, subpoenas should be used for computerized information.

## **28.21 Electronic Communications Privacy Act**

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18 U.S. Code (USC) 2702 prohibits anyone from accessing stored communications and transactional records unless that person or government follows established procedures. Law enforcement must have a valid search and seizure warrant in order to obtain electronic data files. The search warrant must comply with the Federal Rules of Criminal Procedure or the state equivalent. Prior notice to the subscriber or customer is required if a governmental unit uses an administrative subpoena or summons. The court must approve and issue a nondisclosure order to prevent subscriber or customer notification. Attorney's fees and other litigation costs are recoverable by aggrieved parties if they win their case.

## 28.22 Privacy Protection Act

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The Privacy Protection Act (42 USC 2000(aa) et seq.) was enacted to protect the press and certain other persons not suspected of committing a crime with protections not provided by the Fourth Amendment. The Privacy Act protects two classes of materials: work product materials and documentary materials. Work product materials are defined to mean materials that:

- Are prepared or created by any person for communication to the public
- Are possessed for purposes of communication to the public
- Contain mental impressions, conclusions, opinions, or theories of the person who prepared or created such material

Documentary materials are defined to mean materials upon which information is recorded and include written or printed materials, films, video, and any mechanically, magnetically, or electronically recorded cards, tapes, or disks. Both documentary materials and work product materials do not include contraband, fruits of a crime, or materials intended for criminal use. There are two exceptions:

1. A search is permitted if the person possessing the materials has committed the criminal offense to which the materials relate.
2. A search is permitted when it appears that the use of a subpoena or other less intrusive means of obtaining the materials would cause serious bodily injury to a human being.

Under this act, the aggrieved person may seek actual damages, but not less than \$1,000 liquidated damages. Attorney's fees and other litigation costs are also recoverable.

## 28.23 Summary

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Search warrants are a very valuable tool for law enforcement. To obtain a search warrant, the officer or agent must present all the facts so that an independent magistrate can draw the same conclusions that the officer or agent has drawn. The search warrant and the probable cause affidavit must describe in detail the specific evidence the officer or agent is seeking. Without the specificity, a search warrant cannot be obtained, or even worse, the evidence obtained from a bad search may not be admissible in court under the exclusionary rule. Law enforcement should consider the use of a subpoena or summons before considering a search warrant. The requirements of a search warrant state that the officer or agent gather more facts in order to obtain a search warrant. Particular attention should be considered when dealing with financial records and computer files. Commingling of legal and illegal documents presents a litigation hazard for law enforcement.





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## 29.1 Introduction

Computers are increasingly used in our daily lives. We use them at work and at home. We use computers to shop and bank. The banking industry is relying more and more on computers and for their customers to do banking online. It cuts down their payroll expenses. A person can make withdrawals, deposits, and transfers at automatic teller machines (ATMs). The use of credit cards involves using computers. Most businesses use computers for conducting sales and making inventory purchases. Service businesses and governmental agencies are relying more and more on computers. Government and business are increasingly using the Internet to conduct business. It is a new way of shopping. Some companies are solely on the Internet by using websites. People use the Internet to shop and to communicate with family and friends via electronic mail, called e-mail. Most computer crimes are just new ways to commit old crimes. Criminals who used telephone or mail to commit crimes now use the computers and the Internet. However, computers have made it possible to commit new types of crime.

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## 29.2 Types of Computer Crimes

Computer crimes can be classified into six types:

1. **Fraud.** This involves deception whereby one makes a misrepresentation. It typically involves:
  - a. The creation of nonexistent companies to receive payments, obtain credit, etc. It is a version of corporate identity theft. A criminal can set up a bank account in the name of the company for which he works or has worked. He is in a position to deposit corporate funds to the bank account that he controls and not the company. Former employees use the company for obtaining credit.
  - b. The criminal billing for nonexistent goods and services. If the company receiving the bills has poor internal controls, the bills are paid.
  - c. The criminal manipulating data to create false pictures of an individual's or corporation's financial assets. This is usually referred to as "cooking the books" as it relates to corporations. Its purpose is to present a good financial picture

- for the company. The purpose is to make the company look good for shareholders and creditors. This was one reason for the collapse of Enron and the Imclone debacle. This can result in getting credit or paying dividends or bonuses to officers. For individuals, it is usually done to commit bank fraud by making false application for a loan or shopping for goods and services without paying for them.
- d. Using computer-generated records, e.g., false documents, identification cards, false accounting statements, etc. This is done primarily in identity theft. It is very easy to use computers to generate any kind of false document. Computers are often used by criminals to duplicate false credit or debit cards from stolen information. A criminal group in South Florida put a card reader that looked like an ATM in a shopping mall. When a customer put his or her card into the machine, it appeared that the machine was not working, but in reality, it was reading the information on the credit or debit card. The criminals made duplicates, went to ATMs, and withdrew funds.
  2. **Embezzlement.** This involves employee diversion of company funds for personal use. This is an old type of crime, but computers have provided a new method of committing it.
  3. **Misappropriation of computer time.** This involves unauthorized use of a company's computer facilities for private amusement or gain.
  4. **Theft of programs.** This involves an unauthorized user stealing costly programs from the developer by internal theft or through telecommunications.
  5. **Theft of information.** This involves the following:
    - a. The duplication of information such as mailing or customer lists so they can be sold surreptitiously to competition or other persons who value them
    - b. The illegal acquisition of valuable confidential information of a company. This is often referred to as corporate espionage. It includes such things as:
      - Marketing plans
      - Secret processes
      - Product design
      - Copyrighted material
      - Electronically distributed internal communications
      - Technical data
  6. **Sabotage.** This involves the damage of company property. It is referred to as corporate sabotage. It entails:
    - a. Vandalism against employer. This involves the destruction of computer equipment, e.g., computer CPUs, printers, and other peripherals.
    - b. The company's computer systems being disrupted by viruses or worms.
    - c. Protests. The company's computer systems are invaded by protest groups. They place pop-up notices (a form of advertising) or send e-mails.

### 29.3 Warning Signs of Computer Crime

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There are warning signs that can alert one to possible problems with his computer system. When the following warning signs appear, one should begin an investigation as to the problem.

1. **Suspicious circumstances.** When a person gets on his computer, there may be some things happening that are not normal. For example, you get pop-up advertisements when you are not connected to the Internet or you get a pop-up advertisement that addresses you by name; the home page has mysteriously changed; a search term is entered into Internet Explorer's address bar and you get an unfamiliar site that handles the search; or your system runs noticeably slower than it did before.
2. **Forms not sequential.** Numbered control forms such as purchase orders, invoices, and checks are not recorded or filed in sequential order.
3. **Customer complaints.** There are a large number of customer complaints about billing errors. This usually means false or overbilling or lapping of accounts receivable.
4. **Poor security.** Internal controls over receipts and disbursements are lacking. Also, there are poor controls over access to computers. Passwords are readily available to anyone.

## 29.4 Computer Crime Techniques

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The following are some of the common types of computer crimes:

1. **Salami technique.** This involves the theft of small amounts of assets from a large number of sources without noticeably reducing the whole. Salami slicing uses computers to make electronic transfers of funds from hundreds or even thousands of separate accounts. The amounts stolen are small and most account holders do not notice the theft. But small amounts add up and the thief can end up with a large amount of funds. This is usually found in programs where there are mathematical computations, e.g., mortgage payments, loan payments, annuities, etc.
2. **Logic bomb.** A computer program executed at a specific time or when a specific event occurs detonates these bombs. They are deliberately damaging, but they do not replicate. They are designed to lay dormant within a computer for a period and then explode at some predetermined date or event. Logic bombs are favorites among disgruntled ex-employees because they can set them off any time after their departure.
3. **Electronic eavesdropping.** This involves the interception of electronic messages. This can be easily done if the computer system is using wireless means of communicating.
4. **Trapdoor.** Programmers insert debugging aids that provide breaks in the instructions for insertion of additional code and intermediate output capabilities. Programmers insert instructions that allow them to circumvent these controls.
5. **Personation.** The criminal uses a legitimate user's facilities to gain input into the computer system. This is usually an unauthorized person who uses the access codes of an authorized person to gain access to the computer system.
6. **Masquerading.** The criminal taps into communication lines of a computer network system. By doing so, he can intercept messages and change them or redirect messages or funds.

7. **Data diddling.** This involves changing data before or during entry into the system, forging or counterfeiting documents used for data entry, or exchanging valid disks with modified replacements.
8. **Scavenging.** Obtaining information left around a computer system, in computer room trash cans, and the like.
9. **Wiretapping.** Tapping into a computer's communication links to read the information transmitted between systems and networks.
10. **Trojan horse.** Instructions are covertly placed in a program that causes the computer to perform unauthorized functions but usually allows the intended performance. This is most common in computer-based frauds and sabotage.
11. **Computer viruses.** These are malicious codes that cause damage to system information or deny access to the information through self-replication. Viruses or self-replicating programs are written for the purpose of infecting a computer system. They are usually done through a diskette, Internet, or electronic mail. Some viruses are known to erase all data from the hard drive and make the computer useless. They can even melt down the motherboard.
12. **Rabbits.** These are instructions that order a computer to perform useless tasks endlessly, multiplying evermore work orders until they finally overwhelm the computer and it shuts down.
13. **Worms.** Worms take up residence in a computer and use up space until the machine slows down or crashes.
14. **Cyber pirates.** This involves creating con schemes using the computer, such as investment schemes, work-at-home schemes, insurance scams, etc. In one instance, a cyber pirate lied to an insurance company to collect policy money. The cyber pirate created a phantom ship using the computers of the maritime agency. The cyber pirate took out an insurance policy and later wrecked the ship.

## 29.5 Computer Embezzler Profile

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The FBI has done profiling on various types of criminals. When it comes to computer crimes, it has found the following motivations and personal characteristics:

1. **Motivation.** Cyber criminals have three types of motivation factors:
  - a. Financial commitments. Like other white-collar criminals, they committed the crime for financial gain because of personal financial crises. This could be due to either a lavish lifestyle or some crisis that caused a financial hardship.
  - b. Rationalization. A common characteristic for the criminal is to rationalize his actions. He makes claims to justify his actions. Examples are "I should have got the promotion," "The company owes it to me for the work I've done," and "I deserve the money."
  - c. Challenge. Some people do it for the challenge of seeing whether they can get caught. Computer hackers like the challenge of breaking into computer systems.
2. **Personal characteristics:**
  - a. Male. The common culprit is a white male.
  - b. No criminal record. People who commit computer fraud usually do not have any criminal record; the fraud is usually their first offense.

- c. Married, with one or two children living at home. However, there are many cases where the culprit is a single parent.
- d. Middle-class lifestyle.
- e. Income. The person's income is usually in the top 40% of the population. He generally earns between \$50,000 and \$120,000.
- f. Works alone. The person usually works by himself. He is not closely supervised and is a trusted employee.
- g. Age. The most common age for computer fraud culprits is in the mid-30s. However, in a few cases, young men, 14 to 22 years of age, may hack into computer systems for the challenge of it.
- h. Average take. The average loss is about 120% of the perpetrator's salary.
- i. Education. The computer criminal usually has a bachelor's degree. In some cases, he has a postgraduate degree.

## 29.6 Countermeasures

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There are four basic measures that a company should take to secure its computer systems. This becomes more important as more businesses rely on computer systems.

1. **Audit trail.** The computer system should be able to identify and record:
  - a. Terminal used to gain access.
  - b. When it was accessed.
  - c. Identification of the person who made the unauthorized access.
  - d. Files accessed by the operator.
  - e. How the files were used/what was done to them. This may mean reviewing those files in detail.
2. **Shared responsibility.** There should be more than one person who has access to the computer system or module. All personnel should be instructed on security control procedures. When a business has more than one computer and staff members, then the company should institute computer controls. An employee handling billing should not be able to access payroll, accounts receivable, or accounts payable modules. Any overrides by management should be reviewed by senior management or the internal audit staff. Most commercial computer accounting programs have access controls built into them.
3. **Outside testing.** External and internal auditors should examine the integrity and security of the system. This should be done once a year at a minimum. If there has been a breach of security, then testing should be done more often, as necessary. If the computer is linked to the Internet, then any unauthorized access should be fully investigated.
4. **Hiring practices.** Companies should investigate the backgrounds and employment histories of persons working in their computer operations. Credit reports should be obtained for prospective new hires. Criminal record checks should also be done, and references should be checked. It is unlawful for a reference to disclose the reason for dismissal; however, one can get around this by asking, "Would you rehire this person?" If the answer is no, then this should be a red flag to not hire the person.



## 29.7 Computer Crime Investigation

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### 29.7.1 Preparation

1. Have a basic understanding of computer operations and terminology.
2. Develop the technical skills to direct an investigation that may draw upon the expertise of private consultants.
3. Be aware of the various schemes used to penetrate computer systems.
4. Be able to identify the source documents that can be important evidence in proving your case.

### 29.7.2 Documentary Evidence

1. Documentary evidence is the most important element in computer crime investigation. One should get as much evidence as possible.
2. Forensic science analysis can be used to analyze magnetic tapes, disks, cassettes, input documents, and other relevant material for the following:
  - a. Fingerprints
  - b. Hairs
  - c. Indented writing
  - d. Erasure and alterations
  - e. Handwriting
  - f. Typewriter or printer identification
  - g. Any other evidence that might be relevant
3. To identify the author of a questionable document, consider the following:
  - a. Origin of document
  - b. Contents
  - c. Circumstances of preparation
  - d. Nature of deletions, additions, or other alterations
  - e. Age of document
  - f. Paper source
  - g. Handwriting
  - h. Typewriting

## 29.8 Computer Investigation

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In many fraud cases today, the criminal will use a computer to plan, keep records, or communicate with other conspirators. In other cases, the computer will be the centerpiece of the investigation since it can be used as the tool of the crime or the object of the crime.

It is important to get as much information about a computer system as possible before conducting a search. The following information should be obtained:

1. System configuration. Is it a stand-alone, LAN connection, WAN connection, or some other connection?
2. Type of hardware (CPU), memory, and storage capacity (hard drives, other media)
3. Type and versions of application software, brand names

4. External or internal modem, brand, type, and speed
5. Security system (access controls, encryption). Is the computer password protected? Can it be accessed without the suspect's knowledge?
6. Are there booby traps that destroy information if unauthorized access is attempted? There are antiseizure devices on the market. These devices can erase the hard drive. A VCR recorder on the hard drive will erase it. The removal of the CPU case will activate an inverter, which will trash the hard drive.
7. Where exactly is the system physically located? The investigator should be careful of the surroundings. It is best to remove the system to a forensic laboratory, but circumstances may require the computer system to be examined on the premises.
8. Printers and other peripherals should be seized because they may have memory that can contain important evidence. Other items to consider are multiplexers, routers, bridges, printer servers, and repeaters.

## 29.9 Crime Scene Tool Kit

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It is important to have a portable tool kit when searching microcomputers that consists of operating system software, application software, hardware, and a set of computer maintenance tools, e.g., Phillips screwdrivers and pliers. Current microcomputer software include Microsoft Windows, MS-DOS, and the latest OS software for IBM and Apple computers. Utility software should provide disk editing, data recovery, diagnostics, and virus scanning. Also, tools that may allow one to crack common application-specific password systems should be in the kit. Other hardware to consider are cables, disk drives, tape drives, power supplies, dialed number recorders, surge protectors, and a wrist strap for grounding.

## 29.10 General Conduct of Searches

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When conducting a search of computers, the following guidelines are provided:

1. Immediately get people away from the computer. This will prevent any suspect from destroying computer files or the computer itself.
2. Photograph and videotape the area, screen, front and back of each system, and peripherals.
3. If you decide to unplug the system, do so at the wall or outside power source. (Using the switch may invite an unwanted action, such as reformatting the hard drive or initiating a virus.)
4. If an older system, park the hard drive.
5. Leave a system disk in the drive and tape it to prevent booting from the hard drive. Most computers will not boot if a disk is in the drive.
6. Label all hardware, documentation, disks, and so forth.
7. Take all documents along with the system.
8. Look for documentation containing passwords.
9. Before removing the equipment, check for magnetic fields at doors and sign on (use a compass).

10. Use surge protectors.
11. Use your own software to examine the system.
12. Create bit-stream backup copies from the original storage media to allow restoring to the exact condition.
13. Create forensic search images of seized storage media for review. Never use the evidence itself.
14. Secure the original media sources as critical evidence.
15. Review, search, and inspect the forensic search image system for relevant evidence.
16. Document all steps taken.
17. The defendant may help, but do not let him or her near the machine and ensure that the defendant's rights are not violated.
18. Ensure that a chain of custody is maintained and completely documented for all access and use of evidentiary materials.
19. Prepare detailed reports of findings that present information and support conclusions using a minimum of technical jargon.

### **29.11 Cautions**

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It should be kept in mind that computer evidence can be destroyed with the touch of a keyboard. Computer evidence must be reliable and complete. Search procedures must allow for replication of results by anyone. Defense attorneys will question every aspect of computer evidence. Investigators must follow search procedures, identification processes, and preservation of electronic evidence. Investigators should copy all data from the hard drives and work from the copies. The original hard drives should be safely secured.

### **29.12 Prevention Measures**

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The National Fraud Information Center offers the following suggestions in preventing fraud on the Internet:

1. Never reveal checking account numbers, credit card numbers, or other personal financial data at any website or online service location unless you are sure you know where this information will be directed.
2. After you have subscribed to an online service provider, you may be asked for credit card information or passwords. Do not provide these, since the service provider has ready access to your credit card information and passwords.
3. Never give your Social Security number to anyone on the Internet unless you are applying for credit or contacting the Social Security Administration.
4. Beware of dangerous downloads from the Internet. When downloading programs to see pictures, hear music, play games, etc., you could be downloading a virus that wipes out your computer files or connects your modem to a foreign telephone number, resulting in expensive phone charges. A virus protection program should be installed on your computer to identify and eliminate viruses.
5. Pay the safest way. Credit cards are the safest way to pay for online purchases because you can dispute the charges if you never get the goods or services or if the offer

was misrepresented. Federal law limits your liability to \$50 if someone makes unauthorized charges to your account, and most credit card issuers will remove them completely if you report the problem promptly.

6. Do not believe promises of easy money. If someone claims that you can earn money with little or no work, get a loan or credit card even if you have bad credit, or make money on an investment with little or no risk, it is probably a scam.
7. Understand the offer. A legitimate seller will give you all the details about the products or services, the total price, the delivery time, the refund and cancellation policies, and the terms of any warranty.
8. Be cautious about unsolicited e-mails. They are often fraudulent. If you are familiar with the company or charity that sent you the e-mail and do not want to receive further messages, send a reply asking to be removed from their mailing list.

## **29.13 Exploitation of Children**

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One concern by law enforcement is the exploitation of children using the Internet. Some sex predators attempt to exploit children through the use of the Internet. Some individuals seduce children through attention, affection, kindness, and even gifts. These individuals devote a considerable amount of time, money, and energy in the process. They engage in sexually explicit conversations with children. Some offenders collect and trade pornographic pictures, while others seek face-to-face contact for direct victimization. Computer sex offenders can be any age or sex.

### **29.13.1 Signs for At-Risk Children**

The FBI provided the following signs that a child online might be at risk:

1. The child spends large amounts of time online, especially at night.
2. Pornography is found on the child's computer.
3. The child receives phone calls from unknown men.
4. The child is making long-distance calls to unrecognized numbers.
5. The child receives mail, gifts, or packages from unknown individuals.
6. The child turns the computer monitor off or quickly changes the screen on the monitor when someone enters the room.
7. The child becomes withdrawn from his or her family. This could indicate that the child is a victim of sexual exploitation.
8. The child has an online account belonging to someone else.

### **29.13.2 Suspect a Child Is Communicating with a Sexual Predator**

If you suspect that a child is communicating with a sexual predator, then you should take the following steps:

1. Consider talking openly with the child about your suspicions. Tell them about the dangers.
2. Review what is on the child's computer. Pornography or any kind of sexual communication is a strong warning sign.

3. Use a caller ID service to determine who is calling the child.
4. Install a device that shows telephone numbers that have been dialed from the child's home phone.
5. Monitor the child's access to all types of live electronic communications. Computer sex offenders usually meet potential victims via chat rooms and follow up with e-mails.

### **29.13.3 Prevention Measures against Predators**

The FBI provides the following prevention measures to minimize the chances of a child becoming a victim:

1. Communicate with the child about the potential online danger.
2. Spend time with the children online. Let them show you their favorite online destinations.
3. Keep the computer in a common room in the house, not in the child's bedroom.
4. Utilize parental controls provided by the Internet service provider and/or blocking software. Heavily monitor chat rooms. However, parents should not totally rely on utility mechanisms.
5. Always maintain access to the child's online account and randomly check his or her e-mail.
6. Teach the child responsible use of the resources online. There is more to the online experience than chat rooms.
7. Find out what computer safeguards are utilized by the child's school, public library, and at the homes of the child's friends. These are places where the child could encounter an online predator.
8. Instruct children to:
  - a. Never arrange a face-to-face meeting with someone they met online.
  - b. Never upload pictures of themselves onto the Internet or online service to people they do not personally know.
  - c. Never give out identifying information such as their name, home address, school name, or telephone number.
  - d. Never download pictures from an unknown source, as there is a good chance there could be sexually explicit images.
  - e. Never respond to messages or bulletin board postings that are suggestive, obscene, belligerent, or harassing.
  - f. Never believe everything online to be true.

### **29.14 Summary**

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Computers and the Internet have become very widespread, to the point that it is impossible for businesses, government, and individuals to be without them. Criminals are also relying on computers and the Internet to commit their crimes. It is the responsibility of businesses and individuals to be aware of the types of computer crimes and how to prevent becoming victims. Businesses should be aware of prevention measures to protect their computer systems. When businesses and individuals become victims, they should know the procedures to be taken so successful prosecution can take place. Law enforcement needs to know

the proper procedures for executing a search warrant and protecting the integrity and reliability of computer evidence. The rules of evidence should be strictly followed. Computer evidence can be destroyed by just a stroke on the keyboard or by placement of the computer near a magnetic or electronic pulse. Businesses and law enforcement should use outside computer consultants if they do not have any in-house experts. In many cases, computers are just a new way of committing old crimes, e.g., mail fraud, telemarketing fraud, con scams, etc. However, computers have also provided new types of crimes, e.g., viruses, worms, salami techniques, etc.





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## 30.1 Introduction

Accountants and law enforcement personnel wonder about the future of fraud examiners. These two professions have many common threads: a fraud examiner must be part accountant and part detective. The accountant has a good working knowledge of books and records and the ability to analyze books and records, come up with various schedules and statements, and act as a forensic accountant in court. The detective has the ability to interview witnesses and discover evidence and is knowledgeable about criminal law, especially the rules of evidence. When these elements of both the accountant and the detective are combined, the fraud examiner is formed.

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## 30.2 Law Enforcement

Law enforcement in recent years has come to realize that economic crimes can only be solved by financial information. In order to solve economic crimes, the investigator must have a good working knowledge of financial transactions. Society today has become very sophisticated and complex in doing business. The IRS has met modern needs by forming specialized groups to attack the sophisticated crimes. The FBI has formed specialized squads as well. Many big police departments have formed fraud squads to combat various types of sophisticated, complex fraud schemes. The biggest problem with law enforcement is the lack of adequate personnel and resources to combat white-collar crime. This is particularly true with shrinking budgets and the demand for more resources to combat violent crimes.

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## 30.3 Accounting Profession

The accounting profession has not fully recognized fraud. One principal reason is the belief that fraud is the responsibility of management and law enforcement. Many certified public accounting firms have been successfully sued for failure to uncover fraud. Their main argument is that they are not there to detect fraud, but to render an opinion on the fair presentation of financial statements. However, they do not realize that fraud can have a



big impact on financial statements. It is well established that many companies have gone out of business because of fraud committed by employees and management.

## 30.4 Business

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The business community, for the most part, has taken a laissez-faire attitude. When it finds an employee taking kickbacks or embezzling funds, it usually lets the employee go with the hope of some restitution. It fails to prosecute. When this happens, a signal is sent to other employees that they can steal and get off lightly. In the meantime, the bad employee goes to another employer and commits the same offense. Businesses are reluctant to prosecute because of possible bad publicity. Actually, the reverse takes place. If a business prosecutes a bad employee or customer, then it sends out a positive message.

## 30.5 Fraud Examiner

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The future for the fraud examiner looks very good. The *U.S. News & World Report* reported in its November 11, 1991, issue that forensic accounting would be one of the top 20 professions in the 1990s. It continues to be one of the top professions. In 1988, the Association of Certified Fraud Examiners (ACFE) was established by the Institute for Financial Crime Prevention. This was the beginning for establishing credentials for fraud examiners. Following ACFE, the American College of Forensic Examiners (ACFE) established the certified forensic accountant. In 2001, the Association of Certified Anti-Money Laundering Specialists (ACAMS) was formed. It established certified anti-money laundering specialists (CAMs). Forensic accounting has been around for more than a century, but has not been recognized as a special field of endeavor like other fields in accounting, i.e., tax planning and management services.

### 30.5.1 Association of Certified Fraud Examiners

This association has established minimum qualifications and programs for people who want to choose this field as a career:

1. **Qualifications.** The association requires candidates to have:
  - a. A baccalaureate degree from a recognized institution
  - b. Two years of professional experience in fraud-related matters
  - c. Successful completion of the Uniform CFE examination
2. **Examination.** The Uniform CFE examination tests candidates' knowledge in fraud detection and deterrence. The CFE examination is divided into four parts:
  - a. Investigation. This part addresses principles of interview and interrogation techniques, sources of information, report writing, case files and evidence, and covert investigations.
  - b. Law. This part addresses criminal law, rules of evidence, rights of the accused, privacy laws, and testifying as an expert witness.
  - c. Financial transactions. This part covers accounting and auditing theory, the evaluation of internal controls, financial statement analysis, statistical sampling, audit evidence, and computer fraud.

- d. Criminology. This part covers crime theories, the sociology and psychology of offenders, the criminal justice system, crime statistics, sentencing guidelines, plea bargains, and restitution.

### **30.5.2 Ethics**

The ACFE has promulgated a code of professional ethics. Even though this code of ethics applies to CFEs, it also applies to anyone who works in this field of endeavor. This code of professional ethics is presented as follows:

1. A CFE shall, at all times, demonstrate a commitment to professionalism and diligence in the performance of his or her duties.
2. A CFE shall not engage in any illegal or unethical conduct, or any activity which would constitute a conflict of interest.
3. A CFE shall, at all times, exhibit the highest level of integrity in the performance of all professional assignments, and will accept only assignments for which there is reasonable expectation that the assignment will be completed with professional competence.
4. A CFE will comply with lawful orders of the courts, and will testify to matters truthfully and without bias or prejudice.
5. A CFE, in conducting examinations, will obtain evidence or other documentation to establish a reasonable basis for any opinion rendered. No opinion shall be expressed regarding the guilt or innocence of any person or party.
6. A CFE shall not reveal any confidential information obtained during a professional engagement without proper authorization.
7. A CFE shall reveal all material matters discovered during the course of an examination, which, if omitted, could cause a distortion of the facts.
8. A CFE shall continually strive to increase the competence and effectiveness of professional services performed under his or her direction.

### **30.5.3 Professionalism**

The fraud examiner should possess a quality of professionalism. The characteristics of professionalism are as follows:

1. It is a specialized field of endeavor that can only be acquired by higher, formal education.
2. The profession has strict qualification standards.
3. The profession is recognized and accepted by society.
4. The profession has standards of conduct that govern members of the profession and their relationships with colleagues and the public.
5. A national organization or regulatory agency is present to promote and regulate the professional group.

The CFE is not regulated by state or federal agencies. Like most other professionals, the CFE must maintain and increase professional competence by continuing professional education. This has become more imperative because of the advances in technology and the increase in sophistication of economic crimes.

### **30.5.4 Diligence**

Fraud examiners should be diligent in performing their duties. These duties include, but are not limited to, planning assignments, supervising assistants, avoiding conflicts of interest, obtaining sufficient evidence to form opinions, maintaining confidentiality, and avoiding any distortions.

### **30.5.5 Illegal Conduct**

The fraud examiner is forbidden to participate in any illegal activities. While this seems very clear, there are times when it is not so clear cut. The fraud examiner has to be careful of libel or slander. Improper disclosure of the investigation can result in injury of a subject. The fraud examiner cannot detain any person without proper authority. Fraud examiners cannot make plea agreements; only the court can accept plea agreements. Promises should never be made unless the fraud examiner has the authority to keep them.

### **30.5.6 Unethical Conduct**

The fraud examiner is prohibited from unethical conduct. This is harder to define. The best definition would be any conduct that would discredit the fraud examiner and the profession. Such examples of this would be padding expenses, not fully disclosing all the facts, having financial interest in or with the client, using intoxicants while on duty, lending or borrowing funds from clients, misuse of title, and working a case where the subject is a friend, relative, neighbor, or the like. The key to unethical conduct is how the public perceives the fraud examiner and his or her business and personal dealings. The *Internal Revenue Manual* states that agents cannot use their office for personal gain. This rule also applies to fraud examiners.

### **30.5.7 Integrity**

The fraud examiner should have high integrity. Integrity consists of being honest, trustworthy, loyal, helpful, friendly, and courteous. In other words, the fraud examiner should have high morals.

### **30.5.8 Professional Competence**

This relates to performance of duty. Fraud examiners should conscientiously perform their duties. They should keep abreast of current developments. Relations with associates, clients, and others should be conducted in a manner that will not cause dissension, discord, or disrupt business operations. The fraud examiner should become familiar with his clients' operations, respond to unusual events or conditions, and review evidence and assistants' work.

### **30.5.9 Testimony**

The fraud examiner will have to testify in court on many cases. In some cases, the fraud examiner is the expert or summary witness. This is particularly true in cases involving indirect methods of proving illegal gains. The fraud examiner should only summarize evidence that is introduced into court. Opinions are admissible and sometimes required. However, no opinion regarding the guilt or innocence of the subject is to be expressed.

The fraud examiner should always respond to questions in examination or cross-examination, no more and no less. Answers should never express any bias or prejudice, but always be truthful.

### **30.5.10 Orders of the Court**

The fraud examiner should always obey the orders of the court. Whenever a subpoena or summons is issued by any judicial body of competent authority, it should be obeyed.

### **30.5.11 Obtaining Evidence**

The fraud examiner should obtain sufficient and competent evidence to render an opinion. No opinion should be expressed on the guilt or innocence of any person. Evidence should be obtained by all means possible. This can include inspection, observation, interviews, and various other means. The evidence should be material and relevant.

### **30.5.12 Confidential Information**

For all practical purposes, any information that fraud examiners obtain in the course of their assignment is confidential. Disclosure without proper authorization and to improper people can jeopardize a case. In the case of a grand jury, disclosure is not allowed under any circumstances, except by the court. Privileged information cannot be disclosed to anyone, not even the court. In some cases, the fraud examiner may be retained by an attorney who is representing a client and the examiner's services are for the attorney, who has privileged communication status. In this case, all information that the fraud examiner obtains and analyzes belongs to the attorney. Even though the fraud examiner may retain various files and work papers and has been discharged by the client, confidentiality still remains. However, this confidentiality does not apply when an employee provides information about fraudulent acts, whether of another employee or of himself or herself, since the client is the employer. Another complex situation occurs when the client is committing the fraud. The client holds the highest rank in management. The fraud examiner should withdraw from the engagement and issue a disengagement letter that should state the facts. Fraud examiners are not required to blow the whistle, but circumstances may exist where the fraud examiner is legally required to take action. An attorney should be consulted. The fraud examiner should never let the client promulgate false or misleading reports based on the examiner's work. Certain federal statutes require the fraud examiner to report criminal offenses to the appropriate federal agency.

### **30.5.13 Complete Reporting**

The fraud examiner should always report all the facts, whether they help or hurt the case. Evidence and facts are material if they can influence the report user to come to a different conclusion. An omission of facts or evidence is as much a distortion as stretching the truth. The fraud examiner should gather all the evidence, oral and physical, whether it helps or hurts the case. The fraud examiner should never jump to conclusions.

### 30.5.14 Professional Improvement

The fraud examiner should always strive for improvements and greater knowledge. Most professionals, including fraud examiners, are required to have continuing education in order to learn new methods and techniques. Various organizations, i.e., American Institute of CPAs (AICPA), Institute of Internal Auditors (IIA), Institute of Management Accountants (IMA), and ACFE, offer seminars and programs to enhance examiners' knowledge. In addition, the fraud examiner should keep abreast of local and national news media. They report of new schemes or variations of old schemes that are taking place in one's area. Fraud examiners should be aware of current conditions around them. When new schemes or variations of old schemes are discovered in one's locality, the fraud examiner should think of and plan ways to prevent and detect such schemes.

## 30.6 American College of Forensic Examiners

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The American College of Forensic Examiners has two programs for certification: the certified forensic accountant and the certified medical investigator. Only the certified forensic accountant is addressed here. It uses the designation CrFA<sup>(sm)</sup>.

### 30.6.1 Requirements

The applicant is required to be a member of his State Board of Accountancy; in other words the prospective candidate is required to be a CPA. Also, candidates must be members of the American College of Forensic Examiners. The examination applicants must take has two parts: examination 1 and examination 2. Applicants must also be in compliance with local ordinances, state laws, and federal regulations. Candidates must hold a bachelor's degree in business or have 10 years of accounting-related experience. If a candidate is a CPA, then he or she does not have to take examination 1. It cost \$450 to take both exams and \$225 for only examination 2. The candidate must provide three references.

### 30.6.2 Examination for Certified Forensic Accountant

The examination has five sections:

**Section 1.** Covers judicial procedures and evidence applicable to forensic accounting. It also covers dispute resolution, professional responsibility, and ethics. Pay attention to the Federal Rules of Evidence.

**Section 2.** Discusses the role of the forensic accountant in litigation engagements and testifying.

**Section 3.** Covers fraud investigations, fraudulent financial reporting, and the legal elements of fraud and fraud investigation.

**Section 4.** Addresses services of forensic accountants, damages analysis, and failure in audit, tax, and consulting services.

**Section 5.** Covers valuation of closely held businesses, professional practices, and interests in real estate businesses.

## 30.7 Association of Anti-Money Laundering Specialists

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The Association of Anti-Money Laundering Specialists was formed in 2001. It started its examination process in 2003. It has a worldwide membership. It attracts law enforcement personnel, people from various types of financial institutions, and law, accounting, and consulting companies. The September 11, 2001, terrorist attack spurred this organization into existence, preceded by the Financial Action Task Force with its 40 recommendations to 29 countries on money laundering in 1990.

### 30.7.1 Requirements

Candidates must pass an examination. To be eligible, candidates must have a minimum of 20 qualifying points based on education, certifications, and experience supported by documentation. These qualifying points are based on a credit award system. This organization can schedule in-house examinations for members of an organization.

### 30.7.2 Examination for CAMS

The examination has four sections:

1. **Money laundering risks and methods.** Covers the various methods of money laundering and suspicious activity.
2. **International standards of money laundering compliance.** Addresses the various international, regional, and national legal requirements and laws dealing with money laundering.
3. **Money laundering compliance program.** Covers various anti-money laundering policies, procedures, and controls. The candidate should know what reports are made and to whom.
4. **Conducting or supporting the investigation process.** Addresses the procedures for working with law enforcement and gathering evidence. Also covers issues such as cooperation between countries in confiscation, mutual assistance, and extradition.

## 30.8 Summary

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The fraud examiner has a bright future when it comes to employment opportunities. These opportunities exist in private industry, public accounting, and government. There are three certifications. Fraud examiners must be aware of their responsibilities, obligations, and duties. The fraud examiner must keep abreast of current events and new technologies. Fraud examiners in both the public and private sectors must be aware of the code of ethics. This ensures integrity and professionalism within the profession. Governmental fraud examiners must abide by their departmental rules of ethics and conduct. All federal agencies have rules of ethics and conduct, which usually go far beyond those of the three associations. For instance, many federal agencies either restrict or prohibit outside employment.



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# Appendix A: Federal Reserve Districts and American Bankers Association Numerical System



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## Federal Reserve Districts

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- 1 Boston
- 2 New York
- 3 Philadelphia
- 4 Cleveland
- 5 Richmond
- 6 Atlanta
- 7 Chicago
- 8 St. Louis
- 9 Minneapolis
- 10 Kansas City
- 11 Dallas
- 12 San Francisco

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## The Numerical System of the American Bankers Association

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### Index to Prefix Numbers of Cities and States

Numbers 1 to 49 inclusive are prefixes for cities.  
Numbers 50 to 99 inclusive are prefixes for states.  
Prefix numbers 50 to 58 are eastern states.  
Prefix number 59 is Hawaii.  
Prefix numbers 60 to 69 are southeastern states.  
Prefix numbers 70 to 79 are central states.  
Prefix numbers 80 to 88 are southwestern states.  
Prefix number 89 is Alaska.  
Prefix numbers 90 to 99 are western states and Alaska.  
Prefix number 101 is for U.S. territories.



**Prefix Numbers of Cities in Numerical Order**

- 1 New York, NY
- 2 Chicago, IL
- 3 Philadelphia, PA
- 4 St. Louis, MO
- 5 Boston, MA
- 6 Cleveland, OH
- 7 Baltimore, MD
- 8 Pittsburgh, PA
- 9 Detroit, MI
- 10 Buffalo, NY
- 11 San Francisco, CA
- 12 Milwaukee, WI
- 13 Cincinnati, OH
- 14 New Orleans, LA
- 15 Washington, D.C.
- 16 Los Angeles, CA
- 17 Minneapolis, MN
- 18 Kansas City, MO
- 19 Seattle, WA
- 20 Indianapolis, IN
- 21 Louisville, KY
- 22 St. Paul, MN
- 23 Denver, CO
- 24 Portland, OR
- 25 Columbus, OH
- 26 Memphis, TN
- 27 Omaha, NE
- 28 Spokane, WA
- 29 Albany, NY
- 30 San Antonio, TX
- 31 Salt Lake City, UT
- 32 Dallas, TX
- 33 Des Moines, IA
- 34 Tacoma, WA
- 35 Houston, TX
- 36 St. Joseph, MO
- 37 Fort Worth, TX
- 38 Savannah, GA
- 39 Oklahoma City, OK
- 40 Wichita, KS
- 41 Sioux City, IA
- 42 Pueblo, CO
- 43 Lincoln, NE
- 44 Topeka, KS
- 45 Dubuque, IA
- 46 Galveston, TX
- 47 Cedar Rapids, IA
- 48 Waco, TX
- 49 Muskogee, OK

**Prefix Numbers of States in Numerical Order**

50	New York
51	Connecticut
52	Maine
53	Massachusetts
54	New Hampshire
55	New Jersey
56	Ohio
57	Rhode Island
58	Vermont
59	Hawaii
60	Pennsylvania
61	Alabama
62	Delaware
63	Florida
64	Georgia
65	Maryland
66	North Carolina
67	South Carolina
68	Virginia
69	West Virginia
70	Illinois
71	Indiana
72	Iowa
73	Kentucky
74	Michigan
75	Minnesota
76	Nebraska
77	North Dakota
78	South Dakota
79	Wisconsin
80	Missouri
81	Arkansas
82	Colorado
83	Kansas
84	Louisiana
85	Mississippi
86	Oklahoma
87	Tennessee
88	Texas
89	Alaska
90	California
91	Arizona
92	Idaho
93	Montana
94	Nevada
95	New Mexico
96	Oregon
97	Utah
98	Washington
99	Wyoming
101	Territories



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# Appendix B: Money Laundering Acronyms



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## Government

AFMLS	Asset Forfeiture and Money Laundering Section, Department of Justice
ATF	Bureau of Alcohol, Tobacco, and Firearms, Department of the Treasury
BJA	Bureau of Justice Assistance, Department of Justice
CFTC	Commodity Futures Trading Commission
DEA	Drug Enforcement Administration, Department of Justice
EOUSA	Executive Office of U.S. Attorneys, Department of Justice
FBI	Federal Bureau of Investigation, Department of Justice
FDIC	Federal Deposit Insurance Corporation
Fed	Federal Reserve Board
FinCEN	Financial Crimes Enforcement Network, Department of the Treasury
HIDTA	High-Intensity Drug Trafficking Area
HIFCA	High-Intensity Money Laundering and Related Financial Crime Area
INL	Bureau for International Narcotics and Law Enforcement Affairs, Department of State
IRS-CI	Internal Revenue Service — Criminal Investigations
MLCC	Money Laundering Coordination Center, U.S. Customs Service, Department of the Treasury
NCUA	National Credit Union Administration
OCC	Office of the Comptroller of the Currency, Department of the Treasury
OCDEFT	Organized Crime Drug Enforcement Task Force
OFAC	Office of Foreign Assets Control, Department of the Treasury
OJP	Office of Justice Programs, Department of Justice
ONDCP	Office of National Drug Control Policy
OTS	Office of Thrift Supervision, Department of the Treasury
SEC	Securities and Exchange Commission
SOD	Special Operations Division, Department of Justice
USPIS	U.S. Postal Inspection Service

## U.S. Statutes, Laws, and Reports

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APEC	Asia Pacific Economic Cooperation
APG	Asia Pacific Group on Money Laundering
BSA	Bank Secrecy Act
CHFI	Committee on Hemispheric Financial Issues
FATF	Financial Action Task Force on Money Laundering
FIU	Financial Intelligence Unit
FSF	Financial Stability Forum
GCC	Gulf Cooperation Council
IEEPA	International Emergency Economic Powers Act
IFI	International financial institution
ILEA	International Law Enforcement Academy
IMF	International Monetary Fund
INCSR	International Narcotics Control Strategy Report
MLCA	Money Laundering Control Act of 1986
MLSA	Money Laundering Suppression Act of 1994
NCCT	Noncooperative country or territory
OAS	Organization of American States
OECD	Organization for Economic Cooperation and Development
OFC	Offshore financial center
OGBS	Offshore Group of Banking Supervisors

## General Terminology

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BMPE	Black market peso exchange
GTO	Geographic targeting order
MOU	Memorandum of understanding
MSB	Money services business

## BSA Forms

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CMIR	Currency and Monetary Instrument Report
CTR	Currency Transaction Report
FBAR	Foreign Bank Account Report
SAR	Suspicious Activity Report
SAR-C	Suspicious Activity Report for Casinos
SAR-S	Suspicious Activity Report for Securities Brokers and Dealers

# Appendix C: Internet Sources of Information



Data Source	Free	Internet Address
<i>Federal Government</i>		
Alcohol, Tobacco and Firearms	Yes	atf.ustreas.gov
Bureau of Labor Statistics	Yes	stats.bls.gov
Bureau of Prisons	Yes	www.bop.gov
Bureau of Transportation	Yes	www.bts.gov
Census Bureau	Yes	www.census.gov
Centers for Disease Control	Yes	www.cdc.gov
Central Intelligence Agency	Yes	www.odci.gov
Consumer Information Center	Yes	pueblo.gsa.gov
Copyright Office	Yes	www.loc.gov
Department of Agriculture	Yes	www.usda.gov
Department of Commerce	Yes	www.doc.gov; www.commerce.gov
Department of Education	Yes	www.ed.gov
Department of Energy	Yes	www.doe.gov
Department of Health and Human Services	Yes	www.hhs.gov
Department of Housing and Urban Development	Yes	www.hud.gov
Department of Labor	Yes	www.dol.gov
Department of State	Yes	www.dos.gov
Department of Transportation	Yes	www.dot.gov
Department of Veterans Affairs	Yes	www.va.gov
Environmental Protection Agency	Yes	www.epa.gov
Equal Employment Opportunity Commission	Yes	www.eeoc.gov
Federal Aviation Administration	Yes	www.faa.gov
Federal Communications Commission	Yes	www.fcc.gov
Federal Bureau of Investigation	Yes	www.fbi.gov
Federal Deposit Insurance Corporation	Yes	www.fdic.gov
Federal Election Commission	Yes	www.fec.gov
Federal Law Enforcement Training Center	Yes	www.ustreas.gov
Federal Trade Commission	Yes	www.ftc.gov
FedWorld Information Network	Yes	www.fedworld.gov
Government Accounting Office	Yes	www.gao.gov

Data Source	Free	Internet Address
Government Printing Office	Yes	<a href="http://www.gpo.gov">www.gpo.gov</a>
Library of Congress	Yes	<a href="http://www.loc.gov">www.loc.gov</a>
National Oceanic and Atmospheric Administration	Yes	<a href="http://www.noaa.gov">www.noaa.gov</a>
National Security Agency	Yes	<a href="http://www.nsa.gov">www.nsa.gov</a>
Office of Personnel Management	Yes	<a href="http://www.opm.gov">www.opm.gov</a>
Securities and Exchange Commission	Yes	<a href="http://www.sec.gov">www.sec.gov</a>
Small Business Administration	Yes	<a href="http://www.sbaonline.gov">www.sbaonline.gov</a>
Social Security Administration	Yes	<a href="http://www.ssa.gov">www.ssa.gov</a>
U.S. Air Force	Yes	<a href="http://www.af.mil">www.af.mil</a>
U.S. Army	Yes	<a href="http://www.army.mil">www.army.mil</a>
U.S. Coast Guard	Yes	<a href="http://www.uscg.gov">www.uscg.gov</a>
U.S. Courts	Yes	<a href="http://www.uscourts.gov">www.uscourts.gov</a>
U.S. Department of Justice	Yes	<a href="http://www.usdoj.gov">www.usdoj.gov</a>
U.S. House of Representatives	Yes	<a href="http://www.house.gov">www.house.gov</a>
U.S. Marine Corps	Yes	<a href="http://www.usmc.mil">www.usmc.mil</a>
U.S. Navy	Yes	<a href="http://www.navy.mil">www.navy.mil</a>
U.S. Postal Service	Yes	<a href="http://www.usps.com">www.usps.com</a>
U.S. Senate	Yes	<a href="http://www.senate.gov">www.senate.gov</a>
<i>State Governments</i>		
Alabama	Yes	<a href="http://www.eng.auburn.edu/alabama/map.html">www.eng.auburn.edu/alabama/map.html</a>
Alaska	Yes	<a href="http://www.state.ak.us">www.state.ak.us</a>
Arizona	Yes	<a href="http://www.state.az.us">www.state.az.us</a>
Arkansas	Yes	<a href="http://www.state.ar.us">www.state.ar.us</a>
California	Yes	<a href="http://www.state.ca.us">www.state.ca.us</a>
Colorado	Yes	<a href="http://www.state.co.us">www.state.co.us</a>
Connecticut	Yes	<a href="http://www.state.ct.us">www.state.ct.us</a>
Delaware	Yes	<a href="http://www.state.de.us">www.state.de.us</a>
District of Columbia	Yes	<a href="http://www.dchomepage.net">www.dchomepage.net</a>
Florida	Yes	<a href="http://www.state.fl.us">www.state.fl.us</a>
Georgia	Yes	<a href="http://www.state.ga.us">www.state.ga.us</a>
Hawaii	Yes	<a href="http://www.state.hi.us">www.state.hi.us</a>
Idaho	Yes	<a href="http://www.state.id.us">www.state.id.us</a>
Illinois	Yes	<a href="http://www.state.il.us">www.state.il.us</a>
Indiana	Yes	<a href="http://www.state.in.us">www.state.in.us</a>
Iowa	Yes	<a href="http://www.state.ia.us">www.state.ia.us</a>
Kansas	Yes	<a href="http://www.state.ks.us">www.state.ks.us</a>
Kentucky	Yes	<a href="http://www.state.ky.us">www.state.ky.us</a>
Louisiana	Yes	<a href="http://www.state.la.us">www.state.la.us</a>
Maine	Yes	<a href="http://www.state.me.us">www.state.me.us</a>
Maryland	Yes	<a href="http://www.state.md.us">www.state.md.us</a>
Massachusetts	Yes	<a href="http://www.state.ma.us">www.state.ma.us</a>
Michigan	Yes	<a href="http://www.state.mi.us">www.state.mi.us</a>
Minnesota	Yes	<a href="http://www.state.mn.us">www.state.mn.us</a>
Mississippi	Yes	<a href="http://www.state.ms.us">www.state.ms.us</a>
Missouri	Yes	<a href="http://www.state.mo.us">www.state.mo.us</a>
Montana	Yes	<a href="http://www.state.mt.us">www.state.mt.us</a>
Nebraska	Yes	<a href="http://www.nol.org/state/">www.nol.org/state/</a>
Nevada	Yes	<a href="http://www.state.nv.us">www.state.nv.us</a>

Data Source	Free	Internet Address
New Hampshire	Yes	<a href="http://www.state.nh.us">www.state.nh.us</a>
New Jersey	Yes	<a href="http://www.state.nj.us">www.state.nj.us</a>
New Mexico	Yes	<a href="http://www.state.nm.us">www.state.nm.us</a>
New York	Yes	<a href="http://www.state.ny.us">www.state.ny.us</a>
North Carolina	Yes	<a href="http://www.state.nc.us">www.state.nc.us</a>
North Dakota	Yes	<a href="http://www.state.nd.us">www.state.nd.us</a>
Ohio	Yes	<a href="http://www.state.oh.us">www.state.oh.us</a>
Oklahoma	Yes	<a href="http://www.state.ok.us">www.state.ok.us</a>
Oregon	Yes	<a href="http://www.state.or.us">www.state.or.us</a>
Pennsylvania	Yes	<a href="http://www.state.pa.us">www.state.pa.us</a>
Rhode Island	Yes	<a href="http://www.state.ri.us">www.state.ri.us</a>
South Carolina	Yes	<a href="http://www.state.sc.us">www.state.sc.us</a>
South Dakota	Yes	<a href="http://www.state.sd.us">www.state.sd.us</a>
Tennessee	Yes	<a href="http://www.state.tn.us">www.state.tn.us</a>
Texas	Yes	<a href="http://www.state.tx.us">www.state.tx.us</a>
Utah	Yes	<a href="http://www.state.ut.us">www.state.ut.us</a>
Vermont	Yes	<a href="http://www.state.vt.us">www.state.vt.us</a>
Virginia	Yes	<a href="http://www.state.va.us">www.state.va.us</a>
Washington	Yes	<a href="http://www.state.wa.gov/wahome.html">www.state.wa.gov/wahome.html</a>
West Virginia	Yes	<a href="http://www.state.wv.us">www.state.wv.us</a>
Wisconsin	Yes	<a href="http://www.state.wi.us">www.state.wi.us</a>
Wyoming	Yes	<a href="http://www.state.wy.us">www.state.wy.us</a>
Puerto Rico	Yes	<a href="http://www.pr-edu.com">www.pr-edu.com</a>
<i>International</i>		
Embassies in Washington, D.C.	Yes	<a href="http://www.embassy.org">www.embassy.org</a>
Australian legal information	Yes	<a href="http://austlii.law.uts.edu.au">austlii.law.uts.edu.au</a>
Canadian criminal justice system	Yes	<a href="http://www.criminaldefence.com">www.criminaldefence.com</a>
Central Adjudication Services, U.K.	Yes	<a href="http://www.open.gov.uk/cas/cashome.htm">www.open.gov.uk/cas/cashome.htm</a>
Centre for Defence and International Security	Yes	<a href="http://www.cdiss.org">www.cdiss.org</a>
Court service, U.K.	Yes	<a href="http://www.open.gov.uk/courts/court/">www.open.gov.uk/courts/court/</a>
Crime Stopper online, Australia	Yes	<a href="http://www.crimestoppers.net.au">www.crimestoppers.net.au</a>
Foreign government resources	Yes	<a href="http://www.lib.umich.edu/libhome/Documents.center/foreign.html">www.lib.umich.edu/libhome/Documents.center/foreign.html</a>
Asia Far East Institute for the Prevention of Crime	Yes	<a href="http://www.unafei.or.jp">www.unafei.or.jp</a>
Atlas, Canadian	Yes	<a href="http://www.nais.ccm.emr.ca">www.nais.ccm.emr.ca</a>
European Union home page	Yes	<a href="http://europa.eu.int/index.htm">europa.eu.int/index.htm</a>
Forensic Science Society	Yes	<a href="http://www.demon.co.uk/forensic">www.demon.co.uk/forensic</a>
HM prison service	Yes	<a href="http://www.open.gov.uk/prison/">www.open.gov.uk/prison/</a>
Institute for International Economics	Yes	<a href="http://www.iie.com">www.iie.com</a>
International Association of Crime Analysts	Yes	<a href="http://www.iaca.net">www.iaca.net</a>
International Monetary Fund	Yes	<a href="http://www.imf.org">www.imf.org</a>
International Money Laundering Info Network	Yes	<a href="http://www.imolin.org">www.imolin.org</a>
National Criminal Intelligence Service, U.K.	Yes	<a href="http://www.open.gov.uk/ncis/ncishome.htm">www.open.gov.uk/ncis/ncishome.htm</a>
Office of International CJ	Yes	<a href="http://www.acsp.uic.edu">www.acsp.uic.edu</a>
Organization for Economic Development	Yes	<a href="http://www.oecd.org">www.oecd.org</a>
U.K. Police and Forensic Web	Yes	<a href="http://www.innotts.co.uk">www.innotts.co.uk</a>
U.N. Centre for International Crime	Yes	<a href="http://www.ifs.univie.ac.at">www.ifs.univie.ac.at</a>
U.N. Crime and Justice Info Network	Yes	<a href="http://www.ifs.univie.ac.at">www.ifs.univie.ac.at</a>



Data Source	Free	Internet Address
U.N. International Drug Control Policy	Yes	www.undcp.org
U.N. Interregional Crime and Justice	Yes	www.unicri.it
World Bank	Yes	www.worldbank.org
<i>World Trade Organizations</i>		
Australian Institute of Criminology	Yes	www.aic.gov.au
European Union home page	Yes	www.europa.eu
Financial Action Task Force	Yes	www.fatf-gafi.org
Helsinki Institute for Crime Prevention	Yes	www.joutsen.pp.fi
International Crime Police Organization	Yes	www.interpol.int
NATO	Yes	nato.int
UNAFRI	Yes	www.mukla.gn.apc.org
UNAFEI	Yes	www.niftyserve.or.jp
UNESCO	Yes	www.unesco.org
United Nations	Yes	www.un.org
<i>Directories</i>		
800 number telephone directory	Yes	www.dir800.att.net
American Medical Forensics	Yes	www.emeraldcity.com/crimefiles.htm
American Medical Forensics	Yes	www.amfs.com
Any Who people finder	Yes	www.anywho.com
ATT 800 Toll-Free directory	Yes	www.tollfree.att.net
Attorney information lookups	Yes	www.wld.com
Biz finder database	Yes	www.databaseamerica.com
Business Yellow Pages	Yes	www.ypo.com
Claim providers of America	Yes	www.claims.com
ComFind	Yes	www.comfind.com
Directory of database services	Yes	www.facsnet.org/report_tools/CAR/cardirec.htm
Doctor search database	Yes	ama-assn.org
Dun & Bradstreet	Y/N	www.dnb.com
ESP E-mail Search Program	Yes	www.esp.co.uk
Envirosearch	Yes	www.envirosearch.com
Four 11 People Finder	Yes	www.Four11.com
Health care locator	Yes	www.medaccess.com/locator/hclocate.htm
Index of newspapers	Yes	www.teleport.com
Info Space	Yes	www.infospace.com
Internet Address Finder	Yes	www.iaf.net
Internet sleuth	Yes	www.intbc.com/sleuth/
MapQuest	Yes	www.mapquest.com
MediaFinder	Yes	www.mediafinder.com
Medical and mental health	Yes	www.realtime.net/~mmjw/
Military locator	Yes	www.militarycity.com
Movie/Actor information lookup	Yes	www.internetdatabase.com/movie.htm
Net mailing list locator tool	Yes	www.liszt.com
Net mailing list locator tool	Yes	www.nova.edu/Inter-Links/cgi-bin/lists
Net people finder	Yes	www.whowhere.com
Net usenet filter	Yes	www.reference.com
Newsgroup locator tools	Yes	www.cen.uiuc.edu
Newsgroup locator tools	Yes	tile.net/news/
Newsgroup locator tools	Yes	sunsite.unc.edu/usenet-I/home.html

Data Source	Free	Internet Address
Pharmaceutical information	Yes	www.pharminfo.com
Physician database	Yes	www.medaccess.com/physician/phys01.htm
People finder's search engine	Yes	www.databaseamerica.com/engine/gpfind.htm
Reunion network	Yes	www.reunion.com
Searchable phonebooks	Yes	www.networkx.com
Searchable phonebooks	Yes	www.animax.com
Searchable phonebooks	Yes	www.tollfree.att.net
Searchable phonebooks	Yes	www.bellcore.com
Searchable phonebooks	Yes	www.telephonebook.com
Searchable phonebooks	Yes	www.payphones.com
Searchable phonebooks	Yes	www.infospaceinc.com
Searchable phonebooks	Yes	www.pagenet.net
Searchable phonebooks	Yes	www.searchameria.com
Searchable phonebooks	Yes	www.switchboard.com
Searchable phonebooks	Yes	www.ypo.com
Searchable phonebooks	Yes	www.c2.org
Sex Offender Registry, Indiana	Yes	www.state.in.us/cji/index.html
Social Security Death Index	Yes	www.infobases.com/ssdi/query01.htm
SSN validation database	Yes	www.informus.com/ssnlkup.html
Switchboard	Yes	www.switchboard.com
Telephone directory	Yes	www.switchboard.com
Teleport Internet services	Yes	www.teleport.com/news/
The Big Book	Yes	www.bigbook.com
U.S. and Canadian links to data	Yes	www.searchsystems.net
Who? Where? Search for people	Yes	www.whowhere.com
Will Yancey, Ph.D., C.P.A.	Yes	www.willyyancey.com
World E-mail directory	Yes	www.worldemail.com
World's Most Wanted people	Yes	www.mostwanted.com
World Yellow Pages	Yes	www.wyp.net/Search.html
Yellow Pages directory	Yes	www.bigyellow.com
<i>Search Engines</i>		
Alta Vista	Yes	www.altavista.com
Ask	Yes	www.ask.com
Copernic	Yes	www.copernic.com
Dogpile	Yes	www.dogpile.com
Epilot	Yes	www.epilot.com
Google	Yes	www.google.com
Hot Bot	Yes	www.hobbot.com
Infoseek	Yes	www.infoseek.com
Itools	Yes	www.itools.com
Law Crawler	Yes	www.lawcrawler.com
Lycos	Yes	www.lycos.com
Mamma	Yes	www.mamma.com
Metacrawler	Yes	www.metacrawler.com
Northern Light	No	www.northernlight.com
Open Text	Yes	www.opentext.com
Starting Point	Yes	www.stpt.com
Tenkwizard	Yes	www.tenkwizard.com
Teoma	Yes	www.teoma.com

Data Source	Free	Internet Address
U.S. government website searches	Yes	www.firstgov.gov
Webcrawler	Yes	www.webcrawler.com
Yahoo	Yes	www.yahoo.com
<i>Industry Data</i>		
Chemical Week	Yes	www.chemweek.com
Medical Group Management Association	Y/N	www.mgma.com
NAICS codes and descriptions	Yes	www.census.gov/epcd/www/naics.html
<i>Legal Information</i>		
Cornell Law/Supreme Court	Yes	www.law.cornell.edu
Legal information	Yes	www.law.cornell.edu
Tax code	Yes	www.law.cornell.edu
Tax news	Yes	www.cch.com
<i>Libraries and Publications</i>		
Book stacks	Yes	www.books.com
Business statistics	Yes	www.bizstats.com
Concise Columbia Encyclopedia	Yes	www.encyclopedia.com
Journal of Finance	Yes	www.afaof.org/jofihome.shtml
Reference Desk — general	Yes	www.refdesk.com
Smithsonian Encyclopedia	Yes	www.si.edu
<i>National Economics</i>		
Fed — Boston	Yes	www.bos.frb.org
Fed — Chicago	Yes	www.bog.frbchi.org
Fed — Cleveland	Yes	www.clev.frb.org
Fed — Dallas	Yes	www.dallasfed.org
Fed — Kansas City	Yes	www.kc.frb.org
Fed — Minneapolis	Yes	www.mpls.frb.fed.us
Fed — New York	Yes	www.ny.frb.org
Fed — Philadelphia	Yes	www.phil.frb.org
Fed — Richmond	Yes	www.rich.frb.org
Fed — San Francisco	Yes	www.frbsf.org
Fed — St. Louis	Yes	www.stls.frb.org
SIC codes and descriptions	Yes	www.ecrc.uofs.edu/sic.html
Telephone directory	Yes	www.switchboard.com
<i>Useful Resource Providers</i>		
American Society of Appraisers	Yes	www.apo.com
Annual report gallery	Yes	www.ReportGallery.com
Annual report library	Yes	www.zpub.com/sf/arl
Annual report service	Yes	www.Annualreportservice.com
Business information	Yes	www.business.com
Corpwatch	Yes	www.corpwatch.org
Direct Hit	Yes	www.directhit.com
Dun & Bradstreet	Yes	www.dnb.com
Dun & Bradstreet reports	No	www.dbisna.com/dbis/dnbhome.htm
Global company annual report	Yes	www.carol.co.uk
Independent Business Alliance	Yes	www.ibaonline.com
Institute of Business Appraisers	Yes	www.instbusapp.org

Data Source	Free	Internet Address
International Business Brokers Association	Yes	www.ibba.org
Mercer Capital	Yes	www.bizval.com
Shannon Pratt's Business Valuation	Yes	www.transport.com/~shannonp
Standard & Poor's	No	mcgraw-hill.com
State court locator	Yes	www.law.vill.edu
Wealth Planning for closely held corporations	Yes	www.wealthinfo.net
<i>Accounting Research</i>		
Accounting Net	Yes	www.accountingnet.com
FASB	Yes	www.fasb.org
GASB	Yes	www.financenet.gov/gasb.htm
<i>Public Stock Information</i>		
Enhanced SEC EDGAR reports	Yes	www.freedgar.com
Investment resources	Yes	www.infomanage.com/investment
NASDAQ	Yes	www.nasdaq.com
News service, including stock prices	Yes	www.infobeat.com
Securities and Exchange Commission	Yes	www.sec.gov
<i>Miscellaneous</i>		
Currency converter	Yes	www.oanda.com/converter/classic
Global Security Complex	Yes	www.guns-training.com
Insurance fraud research register	Yes	www.ifb.org
Investigative news magazine	Yes	www.offshorebusiness.com
Microsoft online	Yes	www.microsoft.com
Newsmaker profiles — ABC	Yes	www.abcnews.com/reference
Personal investments	Yes	www.INVESTTools.com
PI Magazine	Yes	www.pimall.com
Police resource list	Yes	police.sas.ab.ca
Scam news	Yes	www.quatloos.com
Tax Prophet news (Scams)	Y/N	www.taxprophet.com
The Legal Pad	Yes	www.legal-pad.com
United Parcel Service	Yes	www.ups.com
<i>Associations and Nonprofit Organizations</i>		
American Bar Association	Yes	www.abanet.org
American Gaming Organization	Yes	www.americangaming.org
American Institute of CPAs	Yes	www.aicpa.org
American Society for Industrial Security	Yes	www.asis.com
Association of British Investigators	Yes	www.uklegal.com
Association of Certified Fraud Examiners	Yes	www.acfe.org
Association of Communications Enterprises	Yes	www.ascent.org
Association of Government Accountants	Yes	www.agacgfm.org
Association of Investment Management and Research	Yes	www.cfainstitute.org
Coalition Against Insurance Fraud	Yes	www.insurancefraud.org
Computer Security Institute	Yes	www.gocsi.com
CopNet	Yes	www.copnet.org
Cop Seek	Yes	www.copseek.com
Crime prevention	Yes	www.prevention.gc.ca

Data Source	Free	Internet Address
C-SPAN	Yes	<a href="gopher://c-span.org">gopher://c-span.org</a>
High-Tech Crime Investigation Association	Yes	<a href="http://www.htcia.org">www.htcia.org</a>
Institute of Internal Auditors	Yes	<a href="http://www.theia.org">www.theia.org</a>
Institute of Internal Auditors	Yes	<a href="http://www.iaa.org">www.iaa.org</a>
Institute of Management Accountants	Yes	<a href="http://www.imanet.org">www.imanet.org</a>
International Association of Chiefs of Police	Yes	<a href="http://www.theiacp.org">www.theiacp.org</a>
Internet crime archives	Yes	<a href="http://www.mayhem.net/Crime/archives.html">www.mayhem.net/Crime/archives.html</a>
Investigative reporters and editors	Yes	<a href="http://www.ire.org">www.ire.org</a>
Investigators Open Network	Yes	<a href="http://www.pihome.com">www.pihome.com</a>
Justice information center	Yes	<a href="http://www.ncjrs.org">www.ncjrs.org</a>
National Association of Legal Investigators	Yes	<a href="http://www.nalionline.org">www.nalionline.org</a>
National fraud information center	Yes	<a href="http://www.fraud.org">www.fraud.org</a>
National Institute for Computer-Assisted Reporting	Yes	<a href="http://www.nicar.org">www.nicar.org</a>
North American Society of Tax Advisors	Yes	<a href="http://www.taxadvisors.com">www.taxadvisors.com</a>
Police officers' Internet directory	Yes	<a href="http://www.officer.com">www.officer.com</a>
National Law Enforcement and Corrections Technology Center	Yes	<a href="http://www.nletc.org">www.nletc.org</a>
Rand	Yes	<a href="http://www.rand.org">www.rand.org</a>
VERA Institute of Justice	Yes	<a href="http://www.vera.org">www.vera.org</a>
<i>News Sources</i>		
ABC News online	Yes	<a href="http://www.abcnews.com">www.abcnews.com</a>
Business Week	Yes	<a href="http://www.businessweek.com">www.businessweek.com</a>
CBS	Yes	<a href="http://www.cbs.com">www.cbs.com</a>
CNN	Yes	<a href="http://www.cnn.com">www.cnn.com</a>
DEBKA	Yes	<a href="http://www.debka.com">www.debka.com</a>
Financial Times	Y/N	<a href="http://www.ft.com">www.ft.com</a>
Forbes Magazine	Y/N	<a href="http://www.forbes.com">www.forbes.com</a>
Fortune Magazine	Yes	<a href="http://www.fortune.com">www.fortune.com</a>
Miami Herald	Yes	<a href="http://www.miami.com">www.miami.com</a>
Los Angeles Times	Yes	<a href="http://www.latimes.com">www.latimes.com</a>
MSNBC	Yes	<a href="http://www.msnbc.com">www.msnbc.com</a>
New York Times	Yes	<a href="http://www.nytimes.com">www.nytimes.com</a>
Reuters News Service	Yes	<a href="http://www.reuters.com">www.reuters.com</a>
Time Magazine	Yes	<a href="http://www.time.com">www.time.com</a>
U.S. News & World Report	Yes	<a href="http://www.usnews.com">www.usnews.com</a>
USA Today	Yes	<a href="http://www.usatoday.com">www.usatoday.com</a>
Wall Street Journal	Y/N	<a href="http://www.wsi.com">www.wsi.com</a>
Washington Post	Yes	<a href="http://www.washingtonpost.com">www.washingtonpost.com</a>
World Net Daily	Yes	<a href="http://www.worldnetdaily.com">www.worldnetdaily.com</a>
<i>Commercial Database Services</i>		
AMS	No	<a href="http://www.ams.com">www.ams.com</a>
ASIS Net	No	<a href="http://www.infoinc.com">www.infoinc.com</a>
Auto Check	No	<a href="http://www.autocheck.com">www.autocheck.com</a>
Carfax	No	<a href="http://www.carfax.com">www.carfax.com</a>
Choice Point	No	<a href="http://www.choicepoint.com">www.choicepoint.com</a>
Data-Star/Dialog	No	<a href="http://www.dialog.com">www.dialog.com</a>
Global Scan (USA), Inc.	No	<a href="http://www.iig-associates.com">www.iig-associates.com</a>

Data Source	Free	Internet Address
International Air Transport Association	No	<a href="http://www.iata.org">www.iata.org</a>
Lexis/Nexis	No	<a href="http://www.lexisnexis.com">www.lexisnexis.com</a>
Merlin Information Services	No	<a href="http://www.merlindata.com">www.merlindata.com</a>
Minitel Services Company	No	<a href="http://www.minitel.fr">www.minitel.fr</a>
NCI	No	<a href="http://www.nciinc.com">www.nciinc.com</a>
Pacer	No	<a href="http://pacer.psc.uscourts.gov">pacer.psc.uscourts.gov</a>
Superior online	No	<a href="http://www.superiorinfo.com">www.superiorinfo.com</a>
U.S. Datalink	No	<a href="http://www.usdatalink.com">www.usdatalink.com</a>

*Note:* Some websites are partially free but charge for access to other sections of the site. Various associations allow limited access to the general population, although they give full access to members who subscribe or pay dues.



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# Appendix D: Internet Country Codes



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AD	Andorra
AE	United Arab Emirates
AF	Afghanistan
AG	Antigua and Barbuda
AI	Anguilla
AL	Albania
AM	Armenia
AN	Netherlands Antilles
AO	Angola
AQ	Antarctica
AR	Argentina
AS	American Samoa
AT	Austria
AU	Australia
AW	Aruba
AZ	Azerbaijan
BA	Bosnia and Herzegovina
BB	Barbados
BD	Bangladesh
BE	Belgium
BF	Burkina Faso
BG	Bulgaria
BH	Bahrain
BI	Burundi
BJ	Benin
BM	Bermuda
BN	Brunei Darussalam
BO	Bolivia
BR	Brazil
BS	Bahamas
BT	Bhutan
BV	Bouvet Island
BW	Botswana
BY	Belarus



BZ	Belize
CA	Canada
CC	Cocos (Keeling) Islands
CF	Central African Republic
CG	Congo
CH	Switzerland
CI	Cote D'Ivoire (Ivory Coast)
CK	Cook Islands
CL	Chile
CM	Cameroon
CN	China
CO	Colombia
CR	Costa Rica
CS	Czechoslovakia (former)
CU	Cuba
CV	Cape Verde
CX	Christmas Island
CY	Cyprus
CZ	Czech Republic
DE	Germany
DJ	Djibouti
DK	Denmark
DM	Dominica
DO	Dominican Republic
DZ	Algeria
EC	Ecuador
EE	Estonia
EG	Egypt
EH	Western Sahara
ER	Eritrea
ES	Spain
ET	Ethiopia
FI	Finland
FJ	Fiji
FK	Falkland Islands (Malvinas)
FM	Micronesia
FO	Faroe Islands
FR	France
FX	France, metropolitan
GA	Gabon
GB	Great Britain (U.K.)
GD	Grenada
GE	Georgia
GF	French Guiana
GH	Ghana
GI	Gibraltar
GL	Greenland
GM	Gambia
GN	Guinea
GP	Guadeloupe Equatorial Guinea

GR	Greece
GS	South Georgia and South Sandwich Islands
GT	Guatemala
GU	Guam
GW	Guinea-Bissau
GY	Guyana
HK	Hong Kong
HM	Heard and McDonald Islands
HN	Honduras
HR	Croatia (Hrvatska)
HT	Haiti
HU	Hungary
ID	Indonesia
IE	Ireland
IL	Israel
IN	India
IO	British Indian Ocean Territory
IQ	Iraq
IR	Iran
IS	Iceland
IT	Italy
JM	Jamaica
JO	Jordan
JP	Japan
KE	Kenya
KG	Kyrgyzstan
KH	Cambodia
KI	Kiribati
KM	Comoros
KN	St. Kitts and Nevis
KP	Korea (North)
KR	Korea (South)
KW	Kuwait
KY	Cayman Islands
KZ	Kazakhstan
LA	Laos
LB	Lebanon
LC	St. Lucia
LI	Liechtenstein
LK	Sri Lanka
LR	Liberia
LS	Lesotho
LT	Lithuania
LU	Luxembourg
LV	Latvia
LY	Libya
MA	Morocco
MC	Monaco
MD	Moldova
MG	Madagascar

MH	Marshall Islands
MK	Macedonia
ML	Mali
MM	Myanmar
MN	Mongolia
MO	Macau
MP	North Mariana Islands
MQ	Martinique
MR	Mauritania
MS	Montserrat
MT	Malta
MU	Mauritius
MV	Maldives
MW	Malawi
MX	Mexico
MY	Malaysia
MZ	Mozambique
NA	Namibia
NC	New Caledonia
NE	Niger
NF	Norfolk Island
NG	Nigeria
NI	Nicaragua
NL	Netherlands
NO	Norway
NP	Nepal
NR	Nauru
NT	Neutral zone
NU	Niue
NZ	New Zealand
OM	Oman
PA	Panama
PE	Peru
PF	French Polynesia
PG	Papua New Guinea
PH	Philippines
PK	Pakistan
PL	Poland
PM	St. Pierre and Miquelon
PN	Pitcairn Island
PR	Puerto Rico
PT	Portugal
PW	Palau
PY	Paraguay
QA	Qatar
RE	Reunion
RO	Romania
RU	Russian Federation
RW	Rwanda
SA	Saudi Arabia

SB	Solomon Islands
SC	Seychelles
SD	Sudan
SE	Sweden
SG	Singapore
SH	St. Helena
SI	Slovenia
SJ	Svalbard and Jan Mayen Islands
SK	Slovak Republic
SL	Sierra Leone
SM	San Marino
SN	Senegal
SO	Somalia
ST	Sao Tome and Principe
SU	USSR (former)
SV	El Salvador
SY	Syria
SZ	Swaziland
TC	Turks and Caicos Islands
TD	Chad
TF	French Southern Territories
TG	Togo
TJ	Tajikistan
TK	Tokelau
TM	Turkmenistan
TN	Tunisia
TO	Tonga
TP	East Timor
TR	Turkey
TT	Trinidad and Tobago
TV	Tuvalu
TW	Taiwan
TZ	Tanzania
UA	Ukraine
UG	Uganda
UK	United Kingdom
UM	U.S. minor outlying islands
US	United States
UY	Uruguay
UZ	Uzbekistan
VA	Vatican City
VC	St. Vincent and the Grenadines
VE	Venezuela
VG	Virgin Islands (British)
VI	Virgin Islands (U.S.)
VN	Viet Nam
VU	Vanuatu
WF	Wallis and Futuna Islands
WS	Samoa
YE	Yemen

YT	Mayotte
YU	Yugoslavia
ZA	South Africa
ZM	Zambia
ZR	Zaire
ZW	Zimbabwe

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## Appendix E: Glossary of Common Internet Terms



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**ADN** Advanced Digital Network. Usually refers to a 56-Kbps leased line.

**ADS** Asymmetric Digital Subscriber Line. A method for moving data over regular phone lines. An ADSL circuit is much faster than a regular phone connection, and the wires coming into the subscriber's premises are the same (copper) wires used for regular phone service. An ADSL circuit must be configured to connect two specific locations, similar to a leased line.

**Applet** A small Java program that can be embedded in an HTML page. Applets differ from full-fledged Java applications in that they are not allowed to access certain resources on the local computer, such as files and serial devices (modems, printers, etc.) and are prohibited from communicating with most other computers across a network. The current rule is that an Applet can only make an Internet connection to the computer from which the Applet was sent.

**Archie** A tool (software) for finding files stored on anonymous FTP sites. One needs to know the exact file name or a substring of it.

**ASCII** American Standard Code for Information Interchange. This is the *de facto* world-wide standard for the code numbers used by computers to represent all the upper- and lowercase Latin letters, numbers, punctuation, etc. There are 128 standard ASCII codes, each of which can be represented by a 7-digit binary number: 0000000 through 1111111.

**Bandwidth** How much data one can send through a connection. Usually measured in bits per second. A full page of English text is about 16,000 bits. A fast modem can move about 15,000 bits in 1 second. Full-motion, full-screen video would require roughly 10,000,000 bits per second, depending on compression.

**Baud** In common usage, the baud rate of a modem is how many bits it can send or receive per second. Technically, baud is the number of times per second that the carrier signal shifts value — for example, a 1,200 bit-per-second modem actually runs at 300 baud, but it moves 4 bits per baud ( $4 \times 300 = 1,200$  bits per second).

**BBS** Bulletin board system. A computerized meeting and announcement system that allows people to carry on discussions, upload and download files, and make announcements without being connected to the computer at the same time. There are millions of BBSs around the world; most are very small, running on a single IBM clone PC with one or two phone lines. Some are very large, and the line between a BBS and a system like CompuServe gets crossed at some point, but this line is not clearly drawn.

**Binhex** Binary hexadecimal. A method for converting nontext files (non-ASCII into ASCII). This is needed because Internet e-mail can only handle ASCII.

**Bit** Binary digit. A single-digit number in base 2 — in other words, either a 1 or 0. The smallest unit of computerized data.

**BMP** A graphic bitmap image. The colors of dots or pixels make up the picture. BMP files use the .bmp extension in their file name.

**Browser** A client program (software) that is used to look at various kinds of Internet resources.

**Buried website** A website that does not have a registered domain name. These are typically small sites consisting of web pages on a host ISP.

**Byte** A set of bits that represent a single character. Usually there are 8 bits in a byte, sometimes more, depending on how the measurement is made.

**Client** A software program that is used to contact and obtain data from a server software program on another computer, often across a great distance. Each client program is designed to work with one or more specific kinds of server programs, and each server requires a specific kind of client. A web browser is a specific kind of client.

**Cookie** The most common meaning of “cookie” on the Internet refers to a piece of information sent by a web server to a web browser that the browser software is expected to save and send back to the server whenever the browser makes additional requests from the server. Depending on the type of cookie used and the browser’s settings, the browser may accept or not accept the cookie and may save the cookie for either a short or long time. Cookies might contain information such as login or registration information, online “shopping cart” information, user preferences, etc. When a server receives a request from a browser that includes a cookie, the server is able to use the information stored in the cookie. For example, the server might customize what is sent back to the user, or keep a log of a particular user’s requests. Cookies are usually set to expire after a predetermined amount of time and are usually saved in memory until the browser software is closed down, at which time they may be saved to disk if their expired time has not be reached. Cookies do not read your drive and send your life story to the CIA, but they can be used to gather more information about a user than would be possible without them.

**Cyberspace** Term originated by author William Gibson in his novel *Neuromancer*. The word *cyberspace* is currently used to describe the whole range of information resources available through computer networks.

**Domain name** Domains divide World Wide Web sites into categories based on the nature of their owners, and they form part of the site’s address, or URL. Common top-level domains are:

- .com for commercial enterprises
- .org for nonprofit organizations
- .net for networks
- .edu for educational institutions
- .gov for government organizations
- .mil for military services
- .int for organizations established by international treaty

Additional three-letter and four-letter top-level domains have been proposed, and some are likely to be implemented in the near future. Each country linked to the Web has a two-letter top-level domain, representing the country name, e.g., ca for Canada.

**E-mail** Electronic mail. Messages, usually text, sent from one person to another via computer. E-mail can also be sent automatically to a large number of addresses (mailing list).

**Ethernet** A very common method of networking computers in a LAN. Ethernet will handle about 10,000,000 bits per second and can be used with almost any kind of computer.

**FAQ** Frequently asked questions. A FAQ file is a collection of common questions and answers for a particular subject matter.

**FDDI** Fiber-Distributed Data Interface. A standard for transmitting data on optical fiber cables at a rate of around 100,000,000 bits per second (10 times faster than Ethernet, about twice as fast as T-3).

**Firewall** Firewall refers to the concept of a security interface or gateway between a closed network and the outside Internet that blocks or manages communications in and out of the network. Passwords, authentication techniques, software, and hardware may provide the security.

**FTP** File Transfer Protocol. The Internet protocol that permits one to transfer files from one's system to another system and vice versa. There are various FTP programs available to assist with file transfers, and one can also transfer files directly using one's browser from an FTP website.

**GIF** Graphical interchange format. A bitmap graphical format that is widely used in WWW pages. It is particularly good for text art, cartoon art, poster art, and line drawings. GIF files use a .gif extension in their file name.

**Gigabyte** Either 1,000 or 1,024 megabytes, depending on who is measuring.

**HTML** Hypertext Markup Language. The coding system used to create web pages. A page written in HTML is a text file that includes tags in brackets that control the fonts and type sizes, insertion of graphics, layout of tables and frames, paragraphing, calls to short runnable programs, and hypertext links to other pages. Files written in HTML generally use an .html or .htm extension.

**HTTP** Hypertext Transfer Protocol. The main protocol used on the World Wide Web that enables linking to other websites. Addressing to other web pages begins with http:// and is followed by the domain name or IP address.

**Internet** A network of many networks that interconnect worldwide and use IP.



**Intranet** A network of networks that interconnects within a single widespread organization and uses IP. The sites within an intranet are generally closed to the Internet and are accessible to organization members only.

**IP** Internet Protocol.

**IP address** One of the two forms of Internet addresses in common use. (The domain address is the other one.) IP addresses consist of four numbers between 0 and 255 separated by dots.

**IP number** Sometimes called a dotted quad. A unique number consisting of four parts separated by dots, e.g., 165.113.245.2. Every machine that is on the Internet has a unique IP number. If a machine does not have an IP number, it is not really on the Internet.

**ISP** Internet service provider. An institution that provides access to the Internet in some form, usually for money.

**Java** Java is a network-oriented programming language invented by Sun Microsystems that is specifically designed for writing programs that can be safely downloaded to one's computer through the Internet and immediately run without fear of viruses or other harm to one's computer files.

**JPG, JPEG** Joint Photographic Express Group. A common graphical format that is widely used in WWW pages and is particularly well suited to photographs and three-dimensional images. File names will have a .jpeg, .jpg, or .jpe extension.

**Kilobyte** A thousand bytes. Actually, usually 1,024 bytes.

**LAN** Local area network. A computer network limited to the immediate area, usually the same building or floor of a building.

**Login** The account name used to gain access to a computer system.

**Megabyte** A million bytes. Actually, technically 1,024 kilobytes.

**MIME** Multipurpose Internet Mail Extension. The standard for attaching nontext files to standard Internet mail messages. Nontext files include graphics, spreadsheets, formatted word processor documents, sound files, etc. An e-mail program is said to be MIME compliant if it can both send and receive files using the MIME standard.

**Modem Modulator, Demodulator.** A device that connects to one's computer and a phone line or cable line, allowing the computer to talk to other computers through the phone system. Basically, modems do for computers what a telephone does for humans.

**Netscape** A WWW browser and the name of a company. The Netscape browser was originally based on the Mosaic program developed at the National Center for Supercomputing Applications (NCSA). Netscape has grown rapidly and is widely recognized as a popular web browser. Netscape corporation also produces web server software.

**Network** Any time two or more computers are connected together so that they can share resources. Two or more networks connected together constitute the Internet.

**Password** A code used to gain access to a locked system. Good passwords contain letters and nonletters and are not simple combinations.

**Port** (1) Place where information goes into or out of a computer, or both. (2) On the Internet, port often refers to a number that is part of a URL, appearing after a colon right after the domain name. Every service on an Internet server listens on a particular port number on that server. Most services have standard port numbers.

**Server** A computer or a software package that provides a specific kind of service to client software running on other computers. The term can refer to a particular piece of software, such as WWW server, or to the machine on which the software is running.

**Spam** An inappropriate attempt to use a mailing list or other networked communication facility as if it were a broadcast medium by sending the same message to a large number of people who did not ask for it. The term probably comes from a famous Monty Python skit that featured the word *spam* (there, referring to processed meat) repeated over and over.

**SQL** Structured Query Language. A specialized programming language for sending queries to databases. Most industrial-strength and many smaller database applications can be addressed using SQL.

**SSL** Secure Sockets Layer. A protocol designed by Netscape Communications to enable encrypted, authenticated communications across the Internet. SSL is used mostly in communications between web browsers and web servers. URLs that begin with “https” indicate that an SSL connection will be used. SSL provides three important things: privacy, authentication, and message integrity.

**Sysop** System operator. Anyone responsible for the physical operations of a computer system or network resource.

**T-1** A leased-line connection capable of carrying data at 1,544,000 bits per second. At maximum theoretical capacity, a T-1 could move a megabyte in less than 10 seconds. It is not fast enough for full-screen, full-motion video, for which one needs at least 10,000,000 bits per second.

**T-3** A leased-line connection capable of carrying data at 44,736,000 bits per second. This is more than enough to do full-screen, full-motion video.

**TCP/IP** Transmission Control Protocol/Internet Protocol. This is the suite of protocols that defines the Internet. To be truly on the Internet, one’s computer must have TCP/IP software.

**Terabyte** A thousand gigabytes.

**Typertext** Generally, any text that contains links to other documents — words or phrases in the document that can be chosen by a reader and that cause another document to be retrieved and displayed.

**URL** Uniform resource locator. URLs specify the location or address of a web page. One can type or paste the URL into the address bar of the browser and then connect to it. The IRS URL is <http://www.irs.gov>.

**USENET** A worldwide system of discussion groups, with comments passed among hundreds of thousands of machines. Not all USENET machines are on the Internet. USENET is completely decentralized, with over 10,000 discussion areas, called news groups.

**VPN** Virtual private network. Usually refers to a network in which some of the parts are connected using the public Internet, but the data sent across the Internet are encrypted, so the entire network is virtually private.

**WAN** Wide area network. Any Internet or network that covers an area larger than a single building or campus.

**WWW** World Wide Web, called the Web. An Internet protocol that makes use of HTML and hypermedia to create pages with links to other pages. WWW pages can include graphics, audio, video, as well as text.

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