

HOW DO I GET THE FEDS TO LOOK AT MY FRAUD ISSUE

AND DO I REALLY WANT THEM LOOKING?

By Laurel C. Vant

If a crime is perpetrated at a company, the advantages and disadvantages of going to the authorities should be carefully weighed. Is it worth the possible embarrassment to the company and scrutiny by federal officials? Will your company ever be fully compensated for the loss? Your decision may have a lasting effect on your company, its employees and its stakeholders.

The Association of Certified Fraud Examiners' Report to the Nations on Occupational Fraud and Abuse (ACFE 2018) indicates that fraud due to asset misappropriation schemes account for 89 percent of the reported fraud cases. According to data from the same report, "frauds that last over 60 months are more than 20 times as costly as those that are caught in the first six months."

Although financial statement fraud has a higher loss rate, asset misappropriation schemes are exponentially more damaging to small businesses. The median loss to companies with less than 100

employees is \$200,000, and 42% of the frauds in small businesses are from a lack of internal controls (ACFE 2018).

The author of this article was a special agent with the Internal Revenue Service, Criminal Investigation (IRS-CI) for 27 years and the case detailed below is an investigation that she worked along with the Federal Bureau of Investigation (FBI). The case ultimately led to indictment and prosecution of the accountant who embezzled funds from the company. The names and many of the details have been changed to protect the victim and the defendant.

Details of the Case

Scott Prellen, the son of a local business owner, walked into the offices of the FBI in Dayton, Ohio. He reported to an FBI agent that his accountant had been embezzling from their company, Prellen Realty, LLC. Prellen Realty, LLC was a family-run limited liability company that provided commercial and

residential property management services in the greater Montgomery County, Ohio area. It employed about 10 people in various positions, including marketing, collection, leasing consultant, contract specialist, property manager, supervisors and one accountant. Since it was such a small company, some employees had multiple roles.

The accountant was Deborah Young. When asked what Young's duties and responsibilities were, Prellen stated, "Young did everything. She wrote checks, opened the mail, made deposits, made entries into the software system for each tenant account, and made entries into the company QuickBooks program for accounts payable and accounts receivable. She was our accounting department. Occasionally, the receptionist up front would receive a payment from a customer and give it to Young, but that was an exception."

When asked if tenants paid in cash, Prellen stated that some of their residential customers did,

but they usually paid in person and received a handwritten receipt from a cash-receipts book. Occasionally, the tenants left a cash payment in a dropbox that doubled as a mailbox on the front door, but they discouraged this practice.

Prellen stated that the company maintained multiple cash-receipts books at the same time. One was held by the receptionist at the front desk. Young had a second one and the property manager had a third one in case someone gave him cash while he was onsite at a rental property.

When Young went on vacation, they held all of the accounts receivable and payable entries for her until she got

back from vacation. They also held all the cash receipts in an envelope in her desk for her to deposit at a later date.

About six months prior to his walk-in at the FBI, Prellen noticed that Young took a Disney cruise with six of her family members to the Caribbean. Young and Prellen were Facebook friends and he saw posted photographs of her, her husband, her son and daughter, and her grandchildren in various locations around the Caribbean. Prellen recalled that Young had taken other vacations to Disney World and Hawaii during the previous year.

Prellen began to wonder how Young afforded these vacations. Young

was paid about \$50,000 a year from Prellen Realty and, Prellen believed, her husband could not have made over \$50,000 himself. He believed they were living far beyond their means.

Suspicious, Prellen hired a forensic accountant to review the books to determine if Young was embezzling funds from Prellen Realty. The forensic accountant reviewed the company's books for the prior year. He audited the payables and found no unusual checks made out to Young directly or any other questionable sources. When he tested the cash receipts, he found nothing unusual.

The forensic accountant eventually discovered that there were monthly

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Internal Control Weaknesses

It is important for the victimized company to address the internal control weaknesses promptly after the fraud is reported to the authorities. In most cases, the perpetrator will separate from employment with the victim company. This gives the company a chance to review the position to be filled by one or more employees.

In this example, the following internal controls should be established with the hiring of new employees:

- **Separation of duties** – Two employees should split the accounting functions, including receipt of cash, deposits, and review of invoices and check signing.
- **Oversight by management** – Management should review the bank reconciliation each month and customer charge offs should be approved by management.
- **Invoice review** – Invoices should be reviewed before disbursements are made.
- **Vacations** – Employees should take vacations for at least five consecutive business days; while they are on vacation, another person should complete their tasks.¹
- **Systems' review** – Annual reviews or audits of different systems should be completed.

electronic payments to American Express that were notated on the bank statements as payments for the owner and Scott Prellen's father, Donald Prellen's personal American Express credit card.

After reviewing Donald Prellen's credit card statements, the forensic accountant discovered that these payments were not paying Donald Prellen's credit card bills, but it was not clear what American Express account was being paid. So, he called American Express and they told him that the payments were being made to Deborah Young's personal American Express credit card.

The forensic accountant compiled all the payments to Deborah Young's American Express credit card over the previous year. The total was just over \$124,000. The payments were reported as distributions to Donald Prellen on the company books and Donald Prellen reported the distributions as income to himself on his individual income tax return.

Scott Prellen stated that he confronted Young about the theft and she immediately confessed. Young told Prellen that she spent all of the money on vacations, but she wanted

Scott Prellen did all the right things to convince federal agents to look at his fraud issue. He gathered and provided documentation, hired a forensic accountant and walked into an FBI office to report the fraud.

After the case was completed, was he satisfied with the outcome? What are the implications of a case being investigated and the defendant serving federal time? What kind of damage could the resulting press bring to a company?

The Investigation

After reviewing some of the records that Prellen provided, the FBI agent determined the case was too complex for the FBI alone. He approached an IRS-CI agent and enlisted her help. IRS-CI and the FBI then opened a joint investigation.

The IRS-CI agent conducted her own preliminary interviews with Scott Prellen and sought permission to review all of the forensic accountant's work and the company records herself. After doing so, she was convinced that more fraud was likely to be found if the investigation expanded. Subsequently, the FBI agent and the IRS-CI agent presented

The analysis revealed more cash deposits into the bank account in comparison to the cash receipts books, indicating that some of the records were likely missing. The U.S. Attorney's Office agreed to open a federal grand jury matter against Young.

Once a crime is reported to a federal agency, the victim loses control over the direction and pace of the investigation. The informant cannot simply state they no longer wish to press charges. The victim could refuse to testify or cooperate, but the proverbial bell has been rung and the investigators will do what they need to do to resolve the investigation.

In the above example, Prellen reported a \$124,000 embezzlement to federal agents. By the end of the joint investigation, over \$1 million had been uncovered from two different fraud schemes.

Grand jury subpoenas were issued for Young's bank records and American Express credit card statements for the previous five years. When the bank records were delivered to the federal agents, it was discovered that Young and her husband had two bank accounts for which they both were signors.

An ensuing analysis of the bank account revealed that cash was being deposited into one of these accounts on an almost daily basis going back the full five years under review. The amounts of the cash deposits ranged from \$100 to \$800 for each deposit, but sometimes cash was deposited more than once in a day. Both of the Young's bank accounts were at the same bank where Prellen Realty banked.

Young's American Express credit card statements were also analyzed. Many of the payments were electronic payments from the Prellen Realty account in amounts ranging from about \$9,000 to \$11,000 per month. The electronic payments from Prellen Realty started two and half years

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to pay the company back over time. Young was then fired and escorted out of the building.

Prellen told the FBI agent that Young had worked for Prellen Realty for over 30 years. She had a high school education. Young's family and the Prellen family were friendly; they attended holiday parties with each other and exchanged gifts for birthdays and holidays. He was shocked when an irregularity was found, because both he and his father had long trusted her.

the case to an Assistant United States Attorney (AUSA).

They told the attorney about the wire payments to Young's personal American Express credit card. The IRS-CI agent also explained that they suspected Young had been embezzling for many years based on the lack of controls in the company and the relative sophistication of the AMEX scheme. Also, after a preliminary analysis of the cash-receipts books, she suspected that Young was taking cash receipts.

prior. Before this, the American Express account was being paid by money orders from the U.S. Postal Service and Walmart.

Because of grand jury secrecy rules, agents were not able to report back to the victim. In any such investigation, the victim will likely not know the extent of the investigation until an indictment is made public.

Many of the employees of the company will be interviewed to fully develop an understanding of how each system works within a company, to corroborate the informant's testimony, to uncover other possible schemes, and ascertain whether or not other individuals were involved in the fraud or theft. Computers and servers will be seized and/or imaged (i.e., all the data is copied onto a

The AUSA agreed to the proffer and a meeting was scheduled. Young's lawyer and Young herself were present, but Young was required to answer the IRS-CI agent's questions directly. At the opening of the proffer interview, Young admitted that she caused electronic payments to be made to her American Express credit card totaling \$124,000 from the Prellen Realty bank account. She admitted that she concealed the nature of the transfers by making them look like they were being made to Donald Prellen's personal credit card.

Agents showed Young a spreadsheet listing all the electronic payments made to her credit card from the Prellen Realty account. The payments were for two and half years and totaled \$315,000. Young admitted that it went on for longer than just one year and \$124,000, but she had no idea of the amount.

When asked about theft of cash, Young admitted that she kept some of the cash receipts, but she didn't know how much she took. Young stated that she and her husband had no other sources of income besides their respective jobs. Young was shown another spreadsheet totaling the cash deposited into Young's bank account. The total cash deposited into her account over a five-year period was \$402,000.

Young admitted that prior to the electronic payments from Prellen Realty, she paid her American Express bills with money orders. She stated that she purchased the checks from Walmart, several supermarkets and the U.S. Postal Service with cash. Under examination, Young admitted that she used cash from Prellen Realty to pay for the money orders. Young was shown a spreadsheet with the questionable payments to her American Express credit card, which totaled approximately \$395,000 and spanned a five-year period.

Under further questioning, Young admitted that based on the



Psychological Impact

The psychological impact of an investigation should not be diminished. Anger with the former employee is universal, but often those remaining feel guilty about not discovering the fraud earlier.

Even innocent employees nearly always feel anxious when being questioned by federal agents. Each of these events and steps will likely slow the business' work processes and should be accounted for in any decision regarding involving the authorities.

Generally, federal white-collar investigations last between a year to two years before an indictment is presented to a grand jury. The reason for the length of the investigation is that it takes time to gather documentation from banks and other third parties, analyze these records and interview witnesses.

Sometimes the investigation is prolonged because of scheduling witnesses in the grand jury. The larger the investigation, the more complex and time-consuming it will be, and the owner, employees and stakeholders will be left in the dark.

government computer) and analyzed by technicians and agents to fully develop the evidence in the case.

Admission of Guilt

By this point in the investigation, Young had discovered that Scott Prellen went to the FBI. Prellen filed a lawsuit against Young in an effort to gain restitution of the embezzled funds. In the process of the lawsuit's negotiations, Prellen's lawyer revealed the existence of the federal investigation. Young's lawyer called the AUSA and asked that Young be allowed to proffer.ⁱⁱ

spreadsheets with which she was presented, she embezzled over \$1 million from Prellen Realty. Further, she confessed that she never reported any of these funds on her tax returns. However, she would only admit to details when confronted with evidence already discovered and compiled by the agents.

Young admitted that she spent the majority of the funds on vacations with her family. She did not purchase any assets with the funds. She had about five weeks of vacation each year and she traveled on most of those vacations.

The IRS-CI special agent made a presentation to the grand jury summarizing her findings in the Young investigation. The grand jury

that a fraud had been perpetrated under their watch. Customers may have concerns about the problems within the company being addressed. Outside stakeholders may have concerns about the internal control weaknesses within the company.

If a fraud is reported by a company and the defendant is convicted of the crime and serves time in prison, what are the chances of him/her paying restitution to the company? He/she will not earn a salary while in prison and the chances of future employment in positions that will pay sufficient income to reimburse fraudulent losses is considerably diminished by a felony conviction. The defendant will probably never be able to fully pay back the company.

The lack of resources is an increasing issue because the federal government is not hiring agents as quickly as they are losing them to attrition. If an investigation is dismissed, the company could be a prime target for a lawsuit by the once defendant.

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ENDNOTES

ⁱ Dawson, Steve. *Internal Control/Anti-Fraud Program Design for the Small Business, A Guide for Companies Not Subject to the Sarbanes-Oxley Act*. Hoboken, NJ, Wiley & Sons, 2015.

ⁱⁱ A proffer is a written agreement between the United States Attorney's Office and the target of the investigation in which the target is to answer agents' questions and as long as the target does not lie, the information will not be used against them in any future proceeding. The parties are working towards plea negotiations with this agreement. (FED R Evid. P.410).

ⁱⁱⁱ There are no federal charges for theft or embezzlement. Wire fraud or mail fraud is frequently used in the place of these charges.

^{iv} With the IRS-CI investigating, a tax charge is included, if possible. The IRS views all income as taxable even if from an illegal source.

REFERENCES

Association of Certified Fraud Examiners (ACFE) 2018. *Report to the Nations on Occupational Fraud and Abuse*. Austin, TX: ACFE

Williams, Howard. *Investigating White-Collar Crime, Embezzlement and Financial Fraud*. Springfield, IL: Charles C. Thomas Publisher, LTD, 1997. Print

Federal Rules of Evidence Rule 410.

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voted to indict Young for violations of wire fraud: 18 U.S.C. Section 1343,ⁱⁱⁱ and tax evasion: 26 U.S.C. Section 7201.^{iv}

Young ultimately pleaded guilty to one count each of wire fraud and tax evasion. In the statement of facts filed with the plea agreement, Young admitted that she embezzled more than \$1 million from Prellen Realty.

Young was sentenced in June of 2017 to 51 months of incarceration. She was ordered to pay Prellen Realty \$1.1 million in restitution and \$255,000 to the Internal Revenue Service for tax due for tax years 2011 to 2015.

The sentencing was reported in the local newspapers. Scott and Donald Prellen were present at the sentencing hearing.

Issues to Consider

The owners and managers of a company will likely be embarrassed

The most compelling reason to involve federal authorities is to enlist their power of asset seizure. The Young case was rather unusual because she spent all of the money. Most embezzlers do purchase assets, such as vehicles and properties. If there are such assets that can be directly traced to the scheme perpetrated, the government can seize these assets.

Once the asset is forfeited, the federal government will only deduct a small administration fee out of any net forfeiture proceeds. The remaining funds will go directly to the victim as restitution after the case is adjudicated.

There is a small risk of a fraud investigation being dismissed by federal agencies. The main reasons for dismissal are a lack of proof, contradictory testimony or a lack of resources. It is important for a company to compile evidence and report the crime quickly to diminish these weaknesses.