

Bankruptcy and Divorce Fraud

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Definition

- "The use of one's occupation for personal enrichment through the deliberate misuse of the employing organizations resources or assets"

Trends and Concerns

- Estimated Losses from Fraud

- 1996 -- 400 Billion Dollars
- 2006 -- 660 Billion Dollars

- Estimates are based on 6% of GDP for period

Bankruptcy

Inability to pay debts

Legal petition to courts

Plans developed to repay or liquidate

Chapter 7

Chapter 11

Chapter 13

Liquidate,
Individuals &
Companies

Reorganize &
develop ability to
repay debts,
Individuals &
Companies

Applies to
Individuals with
\$1M or less in
debts

Assumptions

- Debtor will make full disclosure of all assets and liabilities
- Significant delays will occur between filing and when all creditors receive payment
- The threat of prosecution will be a significant deterrent to concealing assets and making false statements

Trends*

- The number of bankruptcies and associated bankruptcy frauds has increased every year over the last five years. - 1997 1,367,364
- This increase has produced a burden to the system reducing resources previously available to detect fraud by the court infrastructure
- *source - Federal Bureau of Investigation

Types of Bankruptcy Fraud

- Bustouts
- Bleedouts
- Assignment for the benefit of the creditor
- Investor Fraud
- Health Care/Welfare
- Rent/Equity skimming

Modus Operandi

- Concealment of assets encompasses 70 percent of bankruptcy fraud
 - Excessive salaries and bonuses
 - New companies are formed just prior to filing
 - Changes in accounting or cash-flow for no apparent reason
 - sudden decrease in inventory

MO - cont'd

- Benefit deductions from employee paychecks that go unpaid to insurer
- Failure to schedule assets
- Undervalue assets
- Transfers of assets pre or post petition

What Roles Do Accountants & Fraud Examiners Play in Bankruptcy Fraud?

- Examiner or trustee
- Serve on creditors' committees & prepare investigative reports
- Assist government with investigative report
- Assist in recovering assets
- Act as private investigators

Most Common Multiple Bankruptcy Fraud Schemes.

1. Filing for bankruptcy in different states using your true personal identifiers
2. Using false names and Social Security numbers to file in the same or two or more states listing nearly identical assets and liabilities

Criminal Bankruptcy Statutes

Concealment of Assets, False Oaths and Claims, and Bribery (18 USC 152)

It is a crime to...

- Conceal property of a debtor's estate from creditors
- Make a false oath or account in a bankruptcy case
- Give, offer, receive, or attempt to obtain money or property, remuneration, compensation, reward, advantage or promise thereof for acting or forbearing to act in a bankruptcy case.

Criminal Bankruptcy Statutes

Embezzlement Against the Debtor's Estate (18 USC 153)

It is a crime for such persons to "knowingly and fraudulently appropriate to [their] own use, embezzle, spend, or transfer" any property, or to hide or destroy any document, belonging to the debtor's estate.

Criminal Bankruptcy Statutes

Adverse Interest and Conduct of Officers

(18 USC 154)

It is a crime to knowingly...

- Purchase, directly or indirectly, any property of the debtor's estate of which the person is an officer in a bankruptcy case
- Refuse to permit a reasonable opportunity for the inspection by parties in interest of the documents and accounts relating to the affairs of the estate in the person's charge when directed by the court to do so.

What Actions Are Criminal?

- Filing for Bankruptcy to Hide a Fraud
- Filing a False Claim
- Providing False or Fraudulent Representation, Claim or Promise to a Bankruptcy Proceeding Either Before or After Petition is Filed



Review Civil Bankruptcy Statues.

Section

- 1144 ■ Revokes Reorganization Plan if Approval Achieved with Fraud
- 1328 ■ Similar to Section 1144 But for an Individual Filed Under Section 13
- 548 ■ Applies to Transfer UP to 1 YR. Before Bankruptcy When Transfer Was Made to Hide Assets and/or Transfers for Less Than Reasonable Equipment, Bargain Transfers

What Steps are Necessary to Prove Fraud?

1. That a false representation, usually one of fact, was made by one of the parties
2. That the defendant's knowledge or belief that the representation was false or was made with reckless indifference to the truth
3. That the defendant showed an intent to induce the plaintiff to act or refrain from acting in a certain way

Bankruptcy & Divorce Schemes

Bust-out

Intentionally obtaining loans or purchasing inventory on a credit basis and concealing, or absconding with, the proceeds from the loan or sale of the inventory or with the inventory itself before creditors are paid.

List 7 Clues to a Bust Out.

1. Company's address & phone are P.O. box & answering service
2. New company owned & managed by out-of-state people or vague about ownership
3. Sudden management change, NO "Public Notice"
4. Can't verify credit references, or references TOO eager to supply

List 7 Clues to a Bust Out.

5. Size of credit orders & credit balances dramatically increase
6. Inventory suddenly disappears, without explanation
7. "Customers" have a history of buying goods At unreasonable discounts

Divorce Fraud

- More than 1 million divorces are filed yearly – 50% of all marriages fail.
- Amicable breakups are not common, rather divorce wars ensue.
- The legal system is an adversarial system where attorneys seek to beat one another.
- One spouse often feels cheated by another and desires to get even.

What Causes Most Divorce Fraud Litigation?

1. The plaintiff's spouse alleges that the defendant hid assets from the divorce court so they would not have to be shared or taken away
2. The values of the assigned assets were unrealistically low, thus resulting in an unfair divorce settlement

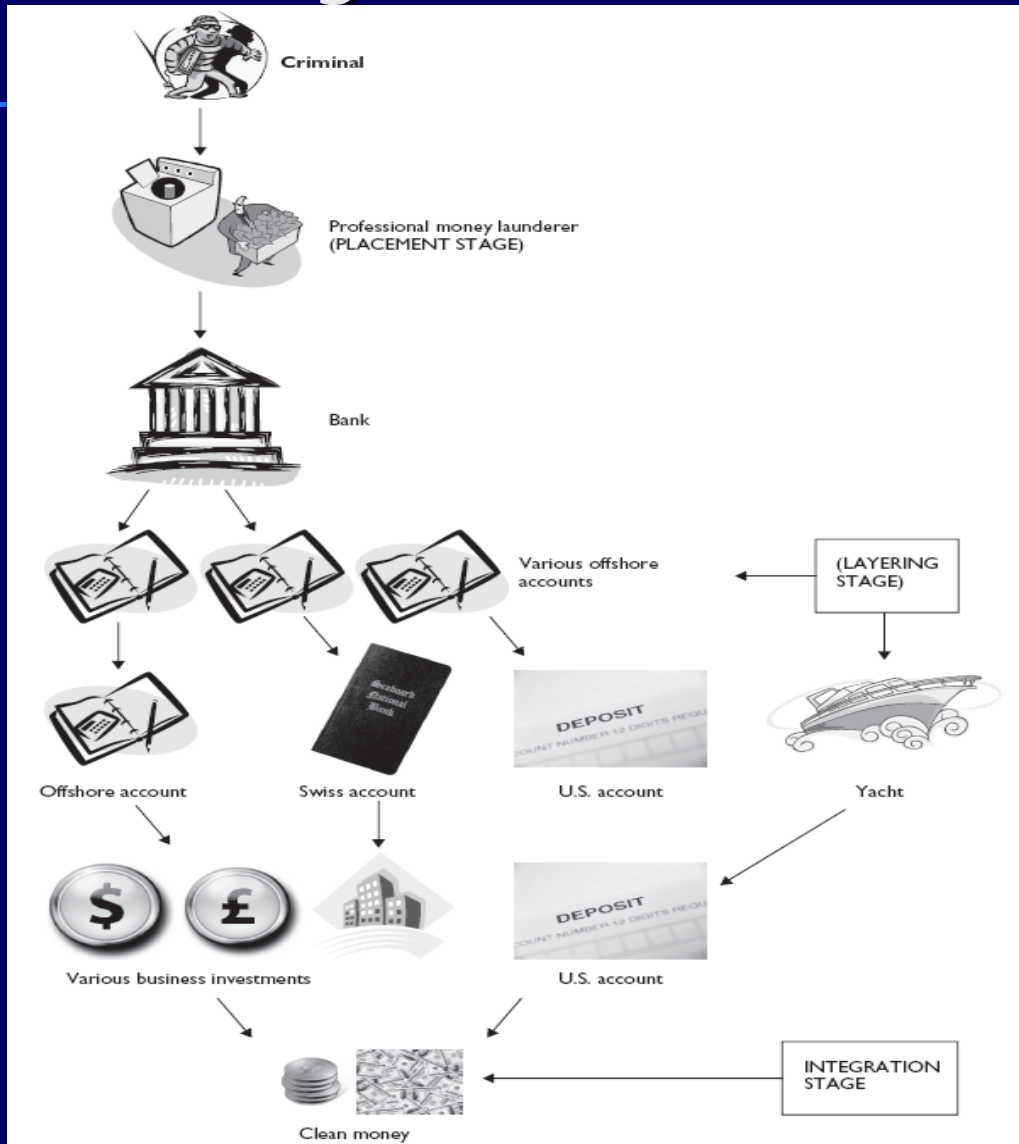
List Ways Cash is Concealed During A Divorce.

- Receivable Payments Diverted to Another Entity, Usually Related
- Inventory Shipped to Another Site, Sold to Related Party At Sharp Discount
- Sales Not Reported in Books
- Company Pays Personnel Expenses
- Undisclosed Business Interests

What Are Some Clues to Concealment?

- Frequent & Unusual Bank Transfers
- Cash Transaction Normally Made "ON ACCOUNT"
- Unexplainable, Unusually Large Payments to Vendors
- Unusual or Rapid Asset Reduction
- Travel to Off Shore Tax Havens
- Missing, Inaccurate or Damaged Records

Money Laundering



For more information

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Resources:

[Fraud Examination](#) W. Steve Albrecht et al
Third Edition, Cengage Learning; 2009

Association of Certified Fraud Examiners www.acfe.com

[Fraud Casebook – Lessons from the Bad Side of Business](#) edited by Joseph T. Wells,
CFE, CPA; Wiley, 2007