
MAKING CRIME PAY: HOW TO LOCATE HIDDEN ASSETS



Association of Certified Fraud Examiners

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III. BEGINNING THE INVESTIGATION

This chapter introduces the process of locating and recovering assets and provides a general approach to investigating hidden assets. However, it begins with a case study of Charles Kallestad, a once-prominent businessman who hid assets from his creditors. The case study, which continues throughout this text, illustrates how assets might be hidden.

KALLESTAD CASE STUDY

Before Charles Kallestad suffered a series of financial woes, he lived in luxury. At one time, he owned a helicopter, a private jet, and twenty luxury automobiles, including Rolls Royces, Porsches, Mercedes, a Lexus, and a Ferrari. He owned an estate on the Pacific Ocean with a swimming pool that meandered into the estate's living room. He also owned a 15-acre compound in Austin, Texas, that included a ten-car garage. He owned other real estate in Minnesota, California, Colorado, and Texas.

Kallestad began his ascent to financial success when he and his brother started a lucrative medical test kit company in the basement of his father's dental office in Minnesota. Fourteen years after starting the company, the two brothers sold the business for \$100 million. The money realized on the sale, reportedly at \$6.2 million, turned Kallestad into a multimillionaire, allowing him to retire at the age of 46 and live the life of a country gentleman.

Although he was a wealthy man, in 1987, Kallestad renewed a \$3,000,000 unsecured loan from a local Austin bank. The bank was happy to extend the loan to Kallestad because he had paid back previous loans at that branch. With the banking industry in chaos due to the savings and loan scandals of the 1980s, however, the bank required collateral. Kallestad obliged, and, although he did not provide enough collateral to cover the loan, he provided enough collateral to satisfy the bank. A year later, the bank required more collateral, and the loan was renewed for another year.

When Kallestad asked for yet another renewal, the bank started showing concern because it did not have enough collateral for the loan, which was now required. Although some of the loan had been paid down due to the sale of one of his homes, the loan balance still exceeded \$2 million. Moreover, the bank grew increasingly concerned because it was finding it hard to get information from Kallestad. Apparently, Kallestad lived everywhere during this time—Santa Barbara, San Diego, Austin—but the bank could never get in touch with him. However, despite the communication difficulties, the bank gave Kallestad an extension for another year using his existing assets as collateral for the remaining balance of the loan.

To continue to service the loan, the bank required Kallestad to provide financial statements. In September 1987, Kallestad provided financial statements indicating a net worth of \$9.2 million. On December 1, 1988, he provided financial information stating that his net worth was \$4.9 million. Six

Beginning the Investigation

months later, he told the bank that his net worth was \$2.6 million. Kallestad also gave the bank an expected cash flow statement of revenues he expected to receive during 1989. Although he indicated to the bank that the expected cash flows might not be realized in 1989 (other than his salary), he nevertheless indicated their expected in-flow. His finances were broken down as follows:

Financial Statements of Charles Kallestad				
	<u>09/30/87</u>	<u>09/30/88*</u>	<u>12/31/88</u>	<u>06/09/89</u>
Current Assets				
Cash	\$50,000	\$25,000	\$50,000	\$15,000
Long-Term Receivables				
N/R NDC	250,000	0	250,000	250,000
N/R Ensun	200,000	0	200,000	200,000
N/R Ramsey				945,000
N/R Fairbanks Lot				525,000
Long-Term Investments				
<u>Real Property</u>				
Minneapolis home	95,000	0	0	0
Minnesota home	147,000	0	0	0
Thief Rivers	100,000	50,000	100,000	80,000
Land 640 acres	256,000	0	0	0
Land 1,134 acres	450,000	25,000	0	0
Land 160 acres	64,000	0	64,000	50,000
Land 640 acres—Plummer	192,000	0	192,000	150,000
Santa Barbara property	4,500,000	2,600,000	3,000,000	0
High Road property	1,250,000	650,000	850,000	700,000
6 Acres St Ed	125,000	30,000	125,000	100,000
Lockhart Ranch	780,000	260,000	780,000	0
<u>Stock</u>				
Research Biogenics	198,500	0	0	0
Other stock	958,534	150,283	200,000	200,000
<u>Other Investments</u>				
Oil Wells	413,000	0	413,000	413,000
I-35 Partnerships	415,000	0	0	386,000
Tax Shelters	1,228,500	0	1,350,000	350,000

* Financial statement given to ex-wife's lawyer. (Source: Trial Exhibits, *Unites States v. Charles O. Kallestad*)

Financial Statements of Charles Kallestad (Cont.)				
	<u>09/30/87</u>	<u>09/30/88*</u>	<u>12/31/88</u>	<u>06/09/89</u>
Personal Property				
Miscellaneous	850,000	150,000	850,000	750,000
Autos & Trucks	375,000	75,000	175,000	100,000
Total Assets	\$12,897,534	\$4,015,283	\$8,599,000	\$5,214,000
Liabilities				
<u>Current Liabilities</u>				
TCB Note		83,000		
<u>Notes Payable</u>				
TCB Note	\$2,950,000	3,150,000	3,077,163	2,584,650
Property—640 acres	125,000			
Property—1134 acres	180,000			
Property—MN property		24,000		
Property—Santa Barbara	420,500	374,000	541,000	0
Charlyn Cook		250,000		
<u>Other Liabilities</u>				
Lawsuit—Chapman Energy		7,000		
Total Liabilities	3,675,500	3,888,000	3,618,163	2,584,650
Net Worth	<u>\$9,222,034</u>	<u>\$127,283</u>	<u>\$4,980,837</u>	<u>\$2,629,350</u>

* Financial statement given to ex-wife's lawyer. (Source: Trial Exhibits, *Unites States v. Charles O. Kallestad*)

Cash Flow Statement*			
Charles O. Kallestad			
As of 6/09/89			
			Expected
			<u>1989</u>
Wages			
Salary—First Fidelity Acceptance Corporation			\$150,000
Income Producing Ventures			
Tres Investments			39,000
I-35 Investments			386,000
TM Leasing			60,000
Notes Receivable			
NDC			250,000
Ensun note			120,000
Other			25,000
Less: living expenses			(24,000)
Expected Cash Flow			<u>\$1,006,000</u>

* Kallestad provided these figures to the bank, but also indicated that \$855,000 was contingent on the sale of certain assets, and he could only receive \$24,000.
(Source: Trial Exhibits, *United States of America v. Charles O. Kallestad*.)

An analysis of the numbers given to the bank should cause concern. Assuming the numbers are correct, Kallestad's net worth dropped more than \$2 million in six months. The financial statements were not audited, so their accuracy depends on the maker's truthfulness and accuracy.

The cash flow statement indicates that Kallestad was capable of earning income, assuming that he provided accurate figures. But because the bank was having trouble locating Kallestad and he kept giving the bank different addresses, these circumstances should have raised a red flag about Kallestad's salary alone.

Of interest, however, is that while Kallestad was painting a rosy financial picture to the bank, he painted a different picture to his ex-wife, who was seeking past-due alimony payments, as well as an increase in alimony. In September 1988, he declared a net worth of \$127,283 to his ex-wife's attorney—this after declaring a net worth of more than \$9 million the previous year. By the end of 1988, he declared a net worth of \$4.9 million, but several months later, after his second divorce in March 1989, he declared a net worth of \$1.46 million. And three months later, in June 1989, he told the bank that his net worth was \$2.6 million.

In the financial statements that Kallestad gave to the bank, he listed investments that turned out to be worthless and did not list assets that actually had value. This is where Kallestad got into serious trouble with the bank, his ex-wife, and the law. Making false statements to a bank is a felony and punishable with fines and prison time.

A more accurate picture of the assets Kallestad represented to the bank on the 6/09/89 financial statement (excluding the assets that he hid from the bank) would look similar to this:

Estimated Financial Statements of Charles Kallestad	
	<u>06/09/89</u>
Current Assets	
Cash	\$15,000
Receivables	
Sale of Santa Barbara property	945,000
Sale of Fairbanks property	525,000
Long-Term Investments	
High Point property	600,000
Personal Property	
Autos & Trucks	50,000
Liabilities	
TCB Note	(2,584,650)
Net Worth	<u>(\$899,300.00)</u>

A more accurate picture of his cash flow was:

Estimated Cash Flow Statement			
Charles O. Kallestad			
			<u>1989</u>
Wages			
Salary—First Fidelity Acceptance Corporation			\$0
Income Producing Ventures			
Tres Investments			0
I-35 Investments			0
TM Leasing			12,000
Oil Well			12
Notes Receivable			
NDC			0
Ensun note			<u>0</u>
Less: living expenses			<u>(24,000)</u>
Expected cash flow			<u><u>(\$11,988)</u></u>

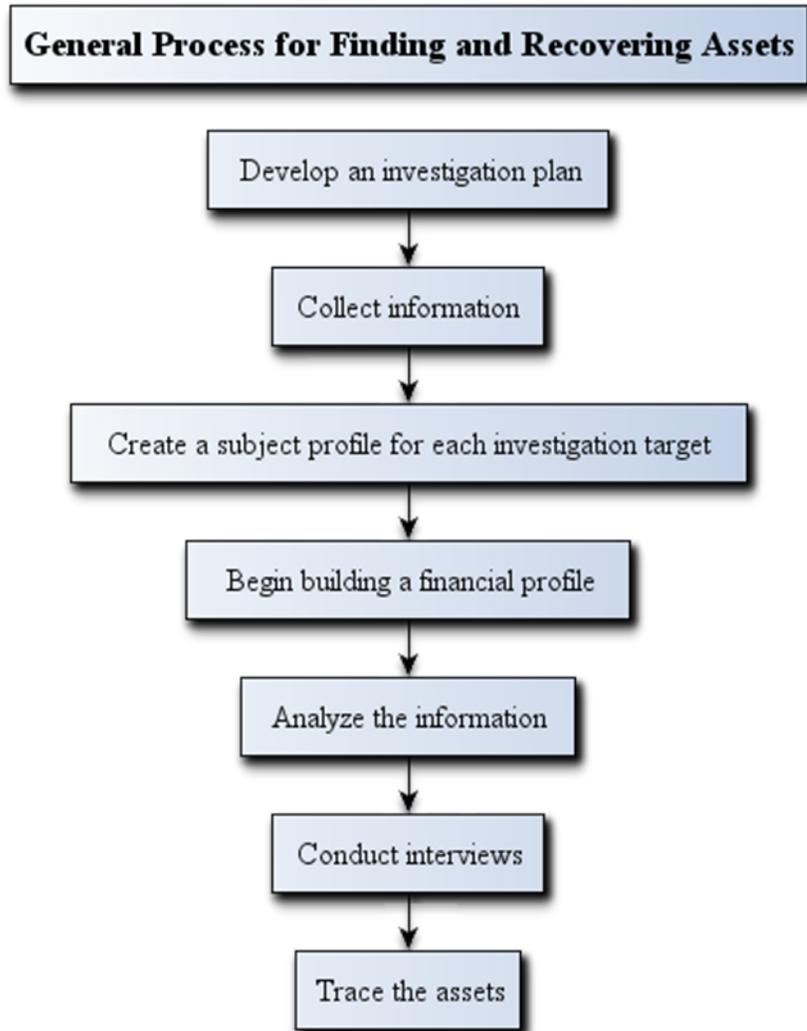
(Source: Witness Testimony, *United States of America v. Charles O. Kallestad*)

Because of the problems the bank had with Kallestad, it decided against renewing his loan and expected payment in full by January 1990. When the loan came due, Kallestad defaulted. Knowing that the bank would seek to use his assets to help cover its losses, he decided to hide his assets.

This case study continues periodically throughout this course.

General Process for Finding Assets

In general, locating and recovering assets involves seven phases, which are listed in the following chart.



Develop an Investigation Plan

When conducting fraud examinations that involve finding hidden assets, fraud examiners must develop an investigative plan. An investigation plan helps fraud examiners identify and organize the steps necessary to complete an investigation.

Moreover, planning helps the fraud examiner address issues in a timely, responsive, and relevant manner, which is important because cases involving hidden assets are time sensitive, and evidence and information can be lost as time progresses. Thus, it is essential to trace assets at the early stages of an investigation.

Also, an investigation plan helps allocate any resources needed to undertake the investigation.

The content of the investigation plan varies depending upon the nature of the case. Investigation plans can be short and simple or long and complex, depending upon the work being undertaken. However, an investigation plan should generally contain the following elements:

- The investigation's objective(s)
- A schedule of tasks to be accomplished, prioritized by how critical each task is to the investigation
- The potential sources of information
- The investigative resources needed
- The team members and their roles, if applicable
- The lines of reporting
- An estimated timeline for completing the investigation
- An estimate of the likelihood of achieving objectives
- An estimate of what potentially is hidden and, if applicable, what can be recovered

When creating an investigation plan for a case involving asset recovery, it helps to develop the context of the case by answering the following questions:

- Who is the subject? Who is hiding assets?
- What motivated the subject to hide the assets?
- How did the subject hide the assets?

Developing the context helps the investigator scope the investigation, which is an important part of the planning process. An investigation, for example, might be limited to the subject matter, the department, or the geographic area at issue, and identifying such limitations helps ensure that attaining realistic objectives and developing alternative strategies is possible. Also, scoping an investigation promotes efficiency, and it helps avoid wasting time and money.

Consequently, if the scope is not identified, the investigation might be doomed to fail, be unreasonably expensive, or both. The scope of an investigation depends on a number of factors, such as:

- The ultimate goals of the investigation
- Key issues involved in the investigation
- The level of confidentiality required
- Any constraints (e.g., time, resource, authority, procedural, legal, practical) on the investigation
- The nature of the case at issue
- The number of people or business units involved in the matter at issue
- The period over which the investigation is relevant

Additionally, by establishing an investigation plan, the fraud examiner is better prepared to focus their efforts and set priorities, which is necessary to the success of any investigation seeking to recover assets. For example, in large-scale cases involving massive amounts of documentation, the fraud examiner might find it useful to focus their efforts on specific types of documents or accounts, or on a specific period. In contrast, if the fraud examiner is investigating a case involving an individual who is accepting bribes, the fraud examiner might focus their efforts on obtaining witness statements of the suspect's business associates, employees, friends, and neighbors; title information on the subject property; and the suspect's tax records.

Additionally, the plan should be a living document. That is, as the investigation proceeds and new information is obtained, the investigative team should review the plan and adapt and update it as necessary.

The following is a list of important considerations for developing an investigative plan:

- The proceeds of fraud might be commingled with other assets not linked to the fraud.
- The proceeds of fraud might change form.
- Relevant assets might flow through various channels.
- Fraudsters typically avoid holding assets or financial accounts in their own name to conceal their role as the individual who owns or controls the assets or accounts.
- Because fraudsters tend to avoid holding assets or financial accounts in their own name, fraud examiners should examine the assets and accounts of those potentially involved in the subject schemes (e.g., relatives, business associates, or close associates; intermediaries or straw men; corporate vehicles, such as corporations, trusts, LLPs, LLCs, foundations).
- Throughout an examination, fraud examiners should assess whether it is possible and feasible to institute processes to seize or restrict assets discovered during their tracing efforts.

Additionally, in the planning phase, it might help to conduct a cost-benefit analysis. A cost-benefit analysis estimates and totals the money value of the benefits and costs to the investigation to determine

whether they are worthwhile. To conduct such an analysis, estimate what potentially can be recovered and estimate what it would cost to recover those items, and compare the two estimates to establish to what extent an investigation would be worthwhile.

Begin Collecting Information

To find hidden assets, fraud examiners must collect information about the parties and assets involved. Because not all of the parties or assets involved are known from the outset of an investigation and might only become known during an investigation, the collecting of information on parties and assets involved is an ongoing process.

Generally, to begin an asset search, fraud examiners need certain information about the subject. So, at the outset, fraud examiners should compile everything they know about the subject. The subject's correct name and address are essential to any asset investigation, and other relevant items of information include:

- The subject's place of employment
- The subject's date of birth
- The subject's email address
- The identities of the subject's close relatives and friends
- The subject's Social Security number
- The subject's last known address
- The names of the subject's close relatives

Much of this basic information can be found in audit documents, business cards and stationery, personnel records, the internet, and conversations with people who know the subject.

Once the fraud examiner has some basic information about the subject, they can use the information to search public records and collect intelligence to trace the assets. They can gather relevant information from online sources, government agency databases, public databases, and through other special investigative techniques. Some techniques might require legal authorization (e.g., electronic surveillance, search and seizure orders, legal orders to produce information, account monitoring orders, etc.), while others might not (e.g., physical surveillance, witness interviews, etc.). Although private investigators do not have the authority granted to law enforcement, they can, in some circumstances, apply to the court for certain civil orders (e.g., legal orders to produce information, orders to conduct on-site reviews of records, orders requiring pre-filing testimony, orders that an expert report be obtained, etc.).

Create a Subject Profile for Each Investigation Target

In all asset investigations, fraud examiners should develop a subject profile for each target of the investigation. The subject profile should contain all available basic information related to the targets, which could include:

- Date of birth
- Place of birth
- Copies of birth certificates
- Copies of passports
- Names and birthdates of immediate relatives (e.g., spouses, children, parents, siblings, spouses of siblings, grandparents, grandchildren, uncles, aunts, cousins, etc.)
- Relevant telephone numbers
- Relevant email addresses
- Contact details of any internet communication by the target
- Recent photographs
- Fingerprint card
- Criminal record search results
- Results of public-information search
- Results of private-records search
- Records of any relevant real estate
- Financial account information

Begin Profiling the Subject

Once the collecting of information is underway, the fraud examiner should begin profiling the subject. Profiling helps organize and view collected information, and it helps facilitate analysis. This course examines two types of profiles later in this chapter: the personal profile and the business profile. The personal—financial and behavioral—profile is used when trying to prove illegal payments from the point of receipt (i.e., from the accounts and financial records of the person suspected of receiving the payments) or when trying to find hidden assets of an individual. In contrast, the business profile begins the process of proving illegal payments or attempts to hide assets from the point of payment (i.e., from the accounts and records of the entity suspected of making the payments).

Analyze the Information

Additionally, once the fraud examiner has begun collecting information, they should begin reviewing and analyzing it. This phase primarily should include the following actions:

- Analyze the information for leads and prioritize the leads.
- Analyze electronic data.
- Identify, compile, and review documents indicating ownership.
- Analyze financial records and begin tracing.

Analyze Information for Leads and Prioritize the Leads

Early on, the fraud examiner should seek to find potential leads that can be followed to feed the investigation. The leads, however, vary depending on the facts of each case. Potential leads might include information to accounts, assets, persons, entities, and technology. More specifically, the leads might include information about:

- The subject's educational background
- The subject's employer
- The subject's occupation
- The subject's marital status
- The names of the subject's family members, friends, or business associates
- The subject's address
- The subject's interests, travel, or hobbies
- The subject's property
- Any membership organizations the subject belongs to

When analyzing data for leads, the fraud examiner should note the names of any attorneys, corporate officers, lending officers, and notaries found on any uncovered records and, when doing so, look for connections between these individuals and the subject.

Also, once the fraud examiner has identified potential leads, they should prioritize them and select those that might result in the development of the most significant evidence in a timely manner.

Analyze Electronic Data

Also, to identify hidden assets, the fraud examiner should analyze electronic data such as email accounts, files, phone registers, and other databases for information indicating any destinations to which the subject might have transferred assets. Electronic data can provide insight into the interactions between the individuals or entities.

Performing keyword searches in electronic data for the names of the individuals and entities relevant to the investigation is beneficial; the information obtained up to this point should indicate those who are relevant.

Identify, Compile, and Review Documents Indicating Ownership

Also, to identify hidden assets, the fraud examiner should identify, compile, and review documents indicating ownership. These documents include contracts, articles of incorporation, partnership agreements, financial statements, court orders, legal filings, bankruptcy filings, title deeds, receipts, bank statements, and vehicle registrations. Often, documents indicating ownership can be found at the subject's office.

This step is necessary to verify the legal owner of specific assets and to determine when the title was established, and it may be used to establish the origins of specific assets or to obtain information on the documents underlying a certain transaction. Additionally, reviewing these documents might indicate when incoming and outgoing payments are due to appear in the relevant accounting systems, and the examiner can use this information in combination with corresponding financial records to identify potentially relevant transactions.

Additionally, when reviewing such documents, the fraud examiner must be alert to signs of forgery, alteration, or fabrication. Although fraud examiners are not expected to be document experts, they should be aware of ways to spot phony documents. Indicators of falsified documents include, but are not limited to:

- A multi-page document containing pages with differences in whiteness, density, thickness, opacity, or fiber patterns
- Documents with evidence of alterations or erasures
- Documents with differences in ink
- Documents that are missing pages
- Documents with signatures that do not match
- Signatures that appear to have been scanned or photocopied
- Documents with dates that appear out of sequence
- Documents missing dates or signatures
- Contracts with little detail
- Contracts with no end date

Analyze Financial Records

Once the fraud examiner has identified, compiled, and reviewed documents indicating ownership and profiled the subject, they should begin analyzing the data for information that can be used to trace the assets. The analysis should look for unexplained changes in the subject's income, expenses, lifestyle, and behavior to determine whether the subject has hidden assets. Such analysis might indicate activities designed to conceal income or to conceal income-producing property.

Here are three key points to consider when analyzing this information:

- What are the sources of the subject's income, assets, and liabilities?
- Is there any missing or inconsistent information?
- Does the subject live a lifestyle that is in excess with the reported income?

For more information on analyzing financial records, see Chapter IV, "Analyzing Financial Records."

Conduct Interviews

Also, the fraud examiner should begin conducting interviews of relevant parties who might have information concerning the matters at issue. An interview is a question-and-answer session designed to elicit information. Information obtained during an interview can corroborate or illuminate information obtained from documentary evidence, identify new financial documents, or expose new leads.

Trace the Assets

After the fraud examiner has identified, compiled, and reviewed documents indicating ownership, they should begin analyzing financial records and begin tracing. Tracing refers to the search for evidence showing what has happened to property, identifying the proceeds of property, and identifying those who have handled or received property or the proceeds of property. That is, tracing involves accounting for the movement of assets in and out of accounts.

Tracing involves identifying those persons, organizations, and assets at issue and the connections between them, and it should include an analysis of the assets and financial flows. For example, once the fraud examiner has established the financial profile, they can compare and contrast the information in the financial profile with known information about suspicious transactions (e.g., dates, origins, destinations, account holders, banks) to group and reconcile the transactions and identify any gaps in data. This helps the fraud examiner understand the flow of assets and identify leads.

Video



In the video titled “Typical Steps in an Asset Investigation” under the CHAPTERS I–III section, David Wall, CFE, CPA, discusses some of the typical steps involved in an asset investigation. (Go to [ACFE.com/makingcrimepay](https://www.acfe.com/makingcrimepay) to view the video.)

Profiling the Subject

Again, once the fraud examiner has begun collecting information, they should begin profiling the subject. Profiling helps organize and view collected information, and it helps facilitate analysis. This discussion examines two types of profiles: the personal profile and the business profile.

The Personal Profile

The personal profile consists of two parts:

- The financial profile
- The behavioral profile

The personal profile is used later in financial analysis to identify non-reported sources of income.

Video

To illustrate the behavioral profile, consider the conduct of convicted fraudster Walt Pavlo. In the video titled “The Personal Profile” under the CHAPTERS III–IV section, Pavlo explains that, while at MCI, he made a conscious effort to make few changes to his lifestyle to avoid drawing much attention to himself. However, he would frequent the Cayman Islands, and once there, he would spend his money freely. (Go to [ACFE.com/makingcrimepay](https://www.acfe.com/makingcrimepay) to view the video.)

Financial Profile

When conducting a search for hidden assets or illegal payments, the fraud examiner should establish a financial profile for the subject. The financial profile is essentially a financial statement with some modifications and additions. It shows what the subject earns, owns, owes, and spends at any given point, or over a period of time; it reflects the subject’s income, expenses, assets, and liabilities. That is, it shows the subject’s financial condition.

The subject’s financial profile contains financial information that can identify inappropriate activity. The numbers in a subject’s financial profile indicate where the subject’s money is coming from (income) and where it is going (expenses).

Accordingly, the financial profile can serve various purposes. It can be used to establish the level of criminality, to build evidence to support litigation, to support a request for an enforcement order, and to identify fund transfers between entities.

The financial profile reveals transactions involving significant amounts, such as large deposits or expenditures, but it does not reveal smaller currency transactions, particularly transactions for concealed activities, consumables, or unusual onetime expenses, such as medical bills.

TWO APPROACHES

The fraud examiner can establish a subject’s financial profile directly or indirectly (circumstantially).

DIRECT APPROACH

A direct approach employs direct evidence demonstrating a subject’s financial standing and profile. That is, it uses the subject’s books and records (or financial transaction records belonging to third parties) to determine the subject’s financial condition. The direct approach requires the fraud examiner to obtain either consent from the subject or a court order to access the requisite records.

To trace financial transactions using a direct method, the fraud examiner uses the information in the individual's financial records to establish the financial profile, which is then used to identify the subject's accounts, assets, and expenditures. And once these items are identified, the examiner obtains and uses them to trace back the source of funds in each. In other words, under the direct process, the fraud examiner traces funds that the subject used to purchase assets or make deposits back to their source.

There are several sources the fraud examiner can use to demonstrate a subject's financial standing and profile under the direct approach, but some common sources include:

- Documents from financial service providers (e.g., accountants or bankers)
- Tax records
- Accounting reports
- Financial statements
- Bank account records
- Payroll records
- Credit reports
- Court records
- Mortgage and loan files
- Credit card records

If the fraud examiner has access to the subject's financial records, they should analyze them to:

- Identify money deposited into the accounts.
- Discover money transferred out of the account by cash withdrawal, check, debit memo, or wire transfer.
- Identify increases and decreases in account balances.
- Create a summary of deposits and withdrawals.
- Develop a summary of checks written on the account.
- Establish a summary of wire transfers into or out of the account.

Also, when analyzing such records, the fraud examiner must be sure to record the dates, amounts, check numbers, names of payees, and name of endorsing bank for any relevant transaction.

If direct evidence of illicit income is not available, the fraud examiner must use an indirect approach.

INDIRECT APPROACH

In many fraud examinations, direct evidence demonstrating a subject's financial standing and profile is not available to the fraud examiner (e.g., the fraud examiner does not have access to the subject's books and records), and in such cases the fraud examiner must use an indirect method, employing circumstantial evidence to analyze the subject's financial information. Indirect methods analyze the

relationship between a suspect's receipt and subsequent disposition of funds. Generally, fraud examiners should use an indirect approach when:

- They do not have access to the subject's books and records.
- The subject's books and records are inadequate.
- The subject has experienced a significant increase in net worth.
- The subject's expenses exceed their reported income.
- They suspect that the subject's income from unidentified sources is large.

In both criminal and civil investigations, indirect methods of proof can reveal that a suspect has more money available than can be accounted for from legitimate sources. In addition, evidence that the suspect lives beyond their means and therefore must have had unexplained income is admissible in court. Such evidence can also be used to corroborate the testimony of co-conspirators as circumstantial evidence of the underlying offense or as evidence to impeach testimony that denies the offense.

There are several sources fraud examiners can employ to establish a subject's financial standing and profile using an indirect approach, including:

- Conducting interviews with the subject
- Conducting interviews with the subject's associates
- Observing the subject's lifestyle habits
- Observing the subject and the subject's assets (e.g., observing the subject's residence, hobbies, vehicles, etc.)
- Using public records (e.g., criminal court records, civil court records, business filings, real property records, etc.)
- Using online resources
- Viewing the subject's charitable contributions
- Obtaining anecdotal information

Other potential sources of information that examiners can use to develop the financial profile include:

- Financial intelligence unit (FIU) reports
- Administrative proceeding documents
- Mutual legal assistance (MLA) requests
- Audit reports
- Whistleblower complaints/reports
- Media outlets
- Nongovernmental organizations (NGO) reports
- Proactive investigations

FIVE-STEP PROCESS

To prepare the financial profile, fraud examiners should take these steps:

Step 1: Identify assets.

Step 2: Identify significant liabilities.

Step 3: Identify income sources.

Step 4: Identify expenses.

Step 5: Calculate the subject's net worth.

See Appendix A for a sample financial profile form that can help develop a subject's financial profile.

STEP 1: IDENTIFY ASSETS

First, identify all significant assets held by the suspect. Remember, an asset is cash (on hand) or anything else of value that can be converted into cash.

Cash on hand comprises coin and currency (e.g., bills, Federal Reserve notes, *greenbacks*) in the subject's possession (i.e., cash on hand that is on the subject's person, in the subject's residence or another place, in a nominee's hands, or in a safe deposit box).

In addition to cash on hand, assets include checking accounts, savings accounts, certificates of deposit, stocks, bonds, mutual funds, real property (residence and other property), vehicles, boats, aircraft, life insurance policies, annuities, business interests, and substantial personal property.

STEP 2: IDENTIFY SIGNIFICANT LIABILITIES

Second, identify all of the subject's significant liabilities. A liability is an obligation or debt arising from an oral or written promise to pay, and it includes mortgages, loans, credit card debt, installment loan payments, and other debts.

STEP 3: IDENTIFY INCOME SOURCES

Third, identify all of the subject's income sources during the relevant time period. Income includes money, or other things of value, received in exchange for services or goods. Income is never included as an asset; it is always listed separately. Loan proceeds are not included as income; instead, they are treated as an asset that is offset by a corresponding liability.

Income sources include:

- Salary
- Spouse's income
- Investment and interest income
- Sale of securities

- Side income (e.g., consulting fees)
- Financial gifts (e.g., money, property)
- Inheritance

STEP 4: IDENTIFY EXPENSES

Fourth, identify all significant expenses incurred by the subject during the relevant period. An expense is any payment for consumables, for either personal or business reasons. Expenses are not included with the subject's liabilities. Expenses include the following items:

- Living expenses
- Travel and entertainment
- Hobbies and collectibles
- Alimony and/or child support

STEP 5: CALCULATE THE SUBJECT'S NET WORTH

Once the fraud examiner has identified the subject's assets, liabilities, income, and expenses and assigned them values, they can calculate the subject's net worth—the difference between a person's assets and liabilities at a specific point in time.

The formula used to calculate a person's net worth can be expressed as:

$$\begin{array}{r} \text{Assets} \\ - \text{Liabilities} \\ \hline \text{Net Worth} \end{array}$$

When seeking to determine a subject's net worth, the fraud examiner should pay special attention to the following:

- All assets should be valued at cost—not fair market value. Subsequent appreciation or depreciation of assets is ignored.
- Cash on hand is the most important asset to establish. Cash on hand (for net-worth purposes) is the currency in the possession of the suspect.
- Currency in financial institutions or currency that is tied up in investments or other assets is not included. It is simply all the currency the suspect physically possesses—whether on them, under a mattress, in a shoebox, or buried in the backyard.

- Cash on hand can potentially be established through analysis of previously filed financial statements, loan and credit card applications, and other records relating to the suspect's financial activity.
- Cash in banks should be reconciled to determine the balances at the end of the period. Unusual transactions that occur near the end of a period should be traced to their ultimate disposition. Large withdrawals that cannot be traced to a specific asset, liability, expenditure, or business expense should be treated as an increase in cash on hand.
- The amount of funds available to the subject from legitimate sources should be estimated or computed generously. The amount of the subject's expenditures, particularly hard-to-document living costs such as food and entertainment, should be estimated conservatively to give the subject the benefit of the doubt.
- Always attempt to interview the subject to identify all alleged sources of funds and to negate defenses that they might raise later.
- Include the income and assets of the subject's spouse in all net-worth calculations.

The Behavioral Profile

Situational factors can affect the reliability of a financial profile, and there might be gaps in information, but such factors and gaps can be identified and filled in through preparing the behavioral profile. The behavioral profile comprises outside pieces of information that can support estimates and fill information gaps.

Information for the behavioral profile is gathered from interviews and observation of lifestyle and habits, as well as from documentary sources.

The behavioral profile contains information about the suspect's personal characteristics (e.g., carries large amounts of cash, wears expensive clothes, or has club memberships), home and furnishings, automobiles, and leisure activities.

Accordingly, the behavioral profile reveals the subject's lifestyle habits (or lifestyle indicators) that might lead to identifying hidden wealth or assets—what is important to them that would cause them to turn to accumulating illicit income—(e.g., where the subject travels, what type of expenditures they make, associates, significant others, pertinent habits, interests, and addictions). The information in the subject's behavioral profile might suggest that they are living beyond their apparent means, and thus probably has hidden income or hidden sources of income.

The following table contains lifestyle indicators that, if present, might suggest that the subject is living beyond their apparent means or has hidden wealth or assets.

Lifestyle Indicators			
Personal Characteristics	Lodging	Transportation	Leisure Activities
Large amounts of cash	Expensive housing	Luxury or exotic cars	Expensive vacations
Designer clothes	Expensive furnishings	Numerous vehicles	Cruises
Expensive jewelry	Valuable art	Late-model vehicles	Boats
Club memberships	Vacation homes		Planes

The behavioral profile complements the financial profile. While the financial profile works best for large transactions, the behavioral profile is best at identifying smaller activities and smaller currency transactions.

Information gathered for the behavioral profile might provide insight into the subject’s motive for the crime or indicate the existence of illicit income or hidden assets. For example, if the suspect spent significant amounts of cash and had no corresponding cash withdrawals from any known bank accounts or no disclosed sources of cash income, the fraud examiner might presume that the suspect must have other, undisclosed sources of income.

The Business Profile

When dealing with money that is moving through business accounts, the fraud examiner should develop a business profile to help them gain an understanding of the company and its industry and allows them to identify any unusual and non-customary occurrences that are present in the business.

The business profile should be used to prove illegal payments or attempts to hide assets from the point of payment or transfer (i.e., from the accounts and records of the entity where the transactions started). The business profile contains all the important information about a subject’s organization, such as its money flow pattern and financial condition, and it identifies prospective witnesses and targets, as well as relevant documents and transactions.

Steps to Establish a Business Profile

The following is a list of steps fraud examiners should take to establish a business profile:

- Determine how the business is legally organized and structured.
- Identify the key personnel associated with the enterprise.
- Identify the money flow patterns of the suspected transactions.
- Locate all of the company’s bank accounts.
- Determine the entity’s financial condition.
- Become familiar with the company’s recordkeeping system.

DETERMINE HOW THE COMPANY IS ORGANIZED AND STRUCTURED

First, the fraud examiner should obtain an understanding of how the business is organized and structured—private, public, or incorporated. Knowing this information helps determine what records are available (e.g., corporate, partnership, etc.) and where to go to obtain them.

IDENTIFY KEY PERSONNEL

Also, it is important to identify key personnel associated with the subject business. This helps identify potential witnesses and informants, as well as possible suspects. Key personnel include:

- The owners of the business and their spouses
- The individuals directly involved in any suspect transactions, including secretarial and clerical staff, both current and former
- Board of directors and officers of the company
- Registered agents
- Internal accountants and bookkeepers, external accountants, and tax preparers
- Outside consultants, sales representatives, and independent contractors who could be recipients of payoffs
- Competitors of the business

IDENTIFY THE MONEY FLOW PATTERNS OF SUSPECTED TRANSACTIONS

Tracing the flow of funds in the suspect transactions is important. That is, the fraud examiner should determine where money comes from and where it goes. Information regarding the source of funds can provide leads as to the type of scheme being used.

To determine the patterns of money flow, the following two steps should be taken:

1. Determine sources of available funds.
2. Identify expenditures related to any suspect transactions.

DETERMINE SOURCES OF AVAILABLE FUNDS

To determine sources of available funds, the fraud examiner must answer the following questions:

- What goods or services does the business provide?
- Who are its customers or clients?
- How is the business paid? Cash? Check? Other?
- What other sources of funds are available? Rebates from suppliers and shippers? Proceeds from insurance claims, liquidation sales, or the sale of assets and loans?

IDENTIFY RELATED EXPENDITURES

Fraud examiners should identify all of the expenditures related to any suspect transactions by answering the following questions:

- What disbursements are made to third parties, such as commissioned sales agents, consultants, subcontractors, suppliers, and shippers?
- Did the business have any extraordinary expenses during the suspect period, such as extra commissions, advertising allowances (payments made by a manufacturer to the retail customer to assist the customer in meeting its advertising expenses), or inventory losses?
- How are the expenses and disbursements paid (cash or check, and from what accounts)?
- Does the business maintain an account or fund that is used to pay miscellaneous expenses? If so, where is it located, who keeps the records, and who signs the checks or authorizes payments?
- How are travel and entertainment expenses reimbursed, and from what account?
- What is the company's practice with respect to business gifts? What gifts were given to the subject or other recipients, how were they paid for, and what records are maintained regarding them?

LOCATE THE COMPANY'S BANK ACCOUNTS

Fraud examiners should also identify all company accounts by bank, account number, and authorized signature. Bank and account information can be found by looking at the bank stamp on checks deposited by the business's customers or, if need be, the fraud examiner can send a check made payable to the business for a small amount and see at what bank it is cashed. Additionally, examiners can look for bank and account information on any loan agreements.

DETERMINE THE COMPANY'S FINANCIAL CONDITION

Learning the financial condition of the business might uncover a motive for the crime. A business that is doing poorly and on the brink of filing for bankruptcy might start to hide assets. If the business owner is going through a divorce or other legal action is filed against them, there might also be a motive to have the financial condition of the business appear unhealthy.

BECOME FAMILIAR WITH THE COMPANY'S RECORDKEEPING SYSTEM

It might also be important to become familiar with the company's recordkeeping system, determining what records the company keeps, for how long, where, and the name(s) of the person(s) who maintains them. Having this information makes it easier to locate relevant records when needed.

Sources of Information for the Business Profile

Information for the business profile can be obtained through:

- The principals, employees, and former employees of the suspect business
- The records of the suspect business

- The customers and competitors of the suspect business
- The banks and lending institutions of the suspect business
- Business reporting companies
- The public business filings of the suspect business

PRINCIPALS, EMPLOYEES, AND FORMER EMPLOYEES OF SUSPECT BUSINESS

To prepare the business profile, the fraud examiner should conduct interviews with key employees, including accounting personnel involved in the suspect transactions. Interviews conducted with former employees can be particularly informative because such individuals might be more comfortable speaking about the company than those that are currently employed.

THE RECORDS OF THE SUSPECT BUSINESS

When preparing the business profile, the fraud examiner should review the suspect business's records. For example, the entity's financial statements and tax returns show its overall financial condition, as well as pending lawsuits, or other significant events.

CUSTOMERS AND COMPETITORS

Customers and competitors can provide valuable information about the payer's business operation, particularly concerning the payer's regular bank account, that can be identified through canceled checks. The customer might also have invoices and shipping documents that might lead to off-book funds.

BANKS AND LENDING INSTITUTIONS

When preparing the business profile, the fraud examiner should obtain information from the suspect entity's banks and lending institutions. The business's banker might have credit applications, financial statements, loan files, and bank account information that could be helpful to the fraud examiner. Moreover, some banks might have the owner's personal financial statements.

BUSINESS REPORTING COMPANIES

Dun & Bradstreet (D&B) Hoover's, Standard & Poor's Capital IQ, and other commercial reporting companies disseminate basic information about businesses, including the size, structure, sales, and number of employees.

BUSINESS PUBLIC FILINGS

Business public filings, such as bankruptcy filings, UCC filings, tax liens, and judgments, can be used to identify adverse financial matters that can serve as potential motivators for fraud. This information might contain useful information on chattel mortgages such as computer equipment, office equipment, automobiles, and other equipment. Other business filings, such as corporate records, give the fraud

examiner the names of the registered agents and board of directors, as well as occupational licenses and other records that might be filed.