

Corruption at the Top

Written by Nick Sanders
Monday, 25 June 2018 00:00

It is perhaps arguable whether anti-corruption training actually reduces instances of employee wrongdoing. After all, one might reasonably expect that employees already know their corrupt behaviors are wrong; do we really think reminding them of the rules one more time is going to affect their decision-making?

It is perhaps more certain that anti-corruption controls, both preventive and detective, reduce instances of employee wrongdoing. If employees know that they are likely to be found out, it might well affect their decision-making. If employees think the company is watching and checking, they might decide not to engage in corrupt behaviors.

But when there is corruption at the top—especially when there is collusion amongst executives who are ostensibly in charge of the anti-corruption controls—well then. That's a different kettle of fish altogether. How are you going to prevent corruption in those circumstances?

It's likely you cannot do so. Collusion makes corrupt behaviors easier to hide and collusion at the top makes them easier to carry out. In such circumstances, perhaps the best one can hope for is detection of the corruption after the fact.

In related news, we have another Department of Justice [press release](#) to discuss. In it, the DoJ announced that “Kristie Lynn McDonald [who] was the Vice President of Finance and Administration of a software company in Sterling, Virginia,” was recently sentenced to 15 months in prison and 3 years of supervised release. She was ordered to pay \$1.813 million in restitution.

What did Ms. McDonald do? According to the press release, she “conspired with the company's Chief Executive Officer Robert Lewis to defraud the United States by failing to pay over to the IRS more than \$1.8 million in payroll taxes withheld from employee paychecks.” The conspiracy to defraud took place over roughly a two-year period, between January 2011 through February 2013.

Interestingly, this DoJ press release actually gave some details of the corruption. It stated—

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McDonald and Lewis circumvented the company's normal payroll and accounting procedures by paying some employees with manual paychecks. The employees still received the correct pay after withholdings, but by bypassing the accounting system, McDonald and Lewis were able to hide the fact that the withholdings were not being paid over to the IRS. ... [In addition] McDonald and Lewis failed to remit the full amount of employee retirement contributions to the company's retirement plan. Through their actions, the company failed to transfer nearly \$225,000 in voluntary employee retirement withholdings.

As part of their scheme, "they also caused the company to file false quarterly employment tax returns with the IRS that underreported the amount of tax due."

The key point in the above is that the normal automated payroll system was bypassed by issuing manual payroll checks. That should have been a red flag to the payroll department; unfortunately, it's likely that the payroll department reported to the VP of Finance and Administration—who probably made up some pretext as to the need for manual paychecks.

Routine payroll reconciliations and/or bank reconciliations might have caught the scheme. But guess who was responsible for seeing that those controls were performed? Yep. The VP of Finance and Administration.

Why did the CEO and VP of Finance and Administration collude together? According to the press release, "McDonald and Lewis used the misappropriated money to pay the operating expenses of the company, which included their own six figure salaries and salary raises for other employees." They needed the cash "to conceal the company's failing financial condition from its Board of Directors."

Thus, it seems that the company had a cash-flow problem. It might even have had trouble making its payroll obligations. Rather than admit the problem and make some hard decisions about the company's future, the CEO and VP of Finance and Administration conspired to steal money from employees (their 401(k) contributions) and from the U.S. Government (the employment taxes).

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Not a good idea. But because the corrupt decision-making was at the top of the company, it was hard to prevent. Those individuals had override authority, and they probably used it to further their scheme. The corporate check on the executives—the Board of Directors—was kept in the dark.

It would be nice to understand how the scheme was finally detected. Did somebody perform a reconciliation and call the IRS? Did the IRS audit the tax returns and see the missing withholdings? We don't know.

But this story provides a reminder that “tone at the top” is a critical aspect of ethics and business conduct systems. When the “tone at the top” is missing, the results tend to show up in the company's financial results. When the corruption is at the top of the company, it's just a matter of time until the company's operations suffer an abrupt end.