

Guide to Judiciary Policy

Vol 8: Probation and Pretrial Services

Pt D: Presentence Investigation Report (Monograph 107)

Ch 1: Overview

Appx 1E: Presentence Report for an Organizational Defendant

The presentence report designed for the sentencing of an individual defendant does not easily accommodate the application of the guidelines for organizations. Since organizations are not subject to the same sanctions as an individual defendant, the structure of the guidelines for organizations is different. This document provides a format for a presentence report on an organization that is intended to provide the factual information necessary for application of the guidelines for organizations and to assist the court in making an informed sentencing decision.

This document has two distinct sections. The first section presents an outline of the format and content of the presentence report for an organization. The elements of information included in each section of the report are outlined with the rationale for organizing the report in this manner. The outline is intended as a reference and checklist for the required content of the report. Figure 1 provides a topical outline of the sections of the report with the pertinent subheadings.

Following the outline, the section entitled “Conducting a Financial Investigation of an Organization” provides a discussion of techniques for gathering information about organizations, focusing primarily on collection and analysis of financial data. Since the principal sanctions available to the court for sentencing an organization are fines and restitution, it is important that the probation officer provide a complete and accurate analysis of the organization's financial profile. Determining an organization's ability to pay financial sanctions requires a process of analysis that differs from the analysis of an individual's ability to pay. A step-by-step discussion of the process is provided in this chapter.

Outline and Contents of the Organizational Presentence Report

Face Sheet

- * Information related to the sentencing hearing includes:
 - * Court of jurisdiction
 - * Identification of the defendant
 - * Sentencing Judge

- * U.S. Probation Officer
- * Prosecutor
- * Defense Counsel
- * Sentencing date

Presentence Report Outline

THE FACE SHEET

PART A. THE OFFENSE

- Charge(s) and Conviction(s)
- The Offense Conduct
- Victim Impact
- Offense Behavior Not Part of Relevant Conduct
- Obstruction of Justice
- Self Reporting/Cooperation/Acceptance of Responsibility

PART B. PRIOR HISTORY OF MISCONDUCT

- Similar Misconduct
- Other Misconduct
- Pending Charges

PART C. ORGANIZATION CHARACTERISTICS

- Organizational Data
- Effective Compliance and Ethics Program
- Financial Condition: Ability to Pay

PART D. GUIDELINE APPLICATION

- Offense Level Computation
- Base Fine Calculation
- Culpability Score Computation
- Fine Range Computation
- Fine Adjustments

PART E. SENTENCING OPTIONS

- Restitution
- Fines
- Probation
- Impact of the Plea Agreement

PART F. FACTORS THAT MAY WARRANT DEPARTURE

ADDENDUM TO THE PRESENTENCE REPORT

RECOMMENDATION

Figure 1

- * Offense data include:
 - * Offense(s) of conviction
 - * Maximum Statutory penalties (fine & probation)
- * Codefendants identified by name and docket number
- * Related Cases identified by name and docket number
- * Dates of preparation of the report and revision of the report
- * The second page of the face sheet contains identifying data:
 - * Federal employer identification number (tax identification number)
 - * Legal address
 - * Other organizational names
 - * Organization representative (spokesperson)

Rationale. The face sheet contains significant court-related information for ease of reference. The second page contains data provided for the use of the sentencing judge, probation officer, and U.S. Sentencing Commission. The "appropriate judge or officer" is required to submit a written report of the sentence to the U.S. Sentencing Commission. The report includes the offense for which the sentence is imposed as well as other factors relevant to the guidelines. 28 U.S.C. § 994(w).¹ Accordingly, submission of copies of the presentence report, judgment, statement of reasons, and written plea agreement (if available) to the Commission will meet these statutory obligations.

PART A. THE OFFENSE

Charge(s) and Conviction(s)

- * Identify specific charge(s) filed against the defendant and any co-defendant(s) in the indictment, information, or complaint.
- * Summarize any superseding indictment(s) or information(s).
- * List the charge(s) of conviction and date(s) of the offense(s).

¹ "The Commission shall assure that the guidelines and policy statements are entirely neutral as to race, sex, national origin, creed, and socioeconomic status of offenders." 28 U.S.C. § 994(D).

- * Report the method(s) of conviction (plea, jury verdict, court verdict, etc.) and date.
- * Identify individual entering plea/accepting verdict on the organization's behalf.
- * Provide a synopsis of the plea agreement (if any).
- * Report the status of the co-defendant(s).
- * Report the status of related cases, including individuals.

Rationale. This section of the report provides a brief chronological history of the prosecution of the case from the filing of the initial charges to the referral to the probation office for a presentence report.

The Offense Conduct

- * Provide a concise but complete description, in chronological order, using significant dates as points of reference, of the organization's conduct and the conduct of codefendants or other participants during the offense of conviction, including planning, preparation for the offense, and the circumstances leading to the detection of the criminal conduct.
- * Present all information about the offense that is relevant to the application of the sentencing guidelines, including the facts pertaining to relevant conduct, specific offense characteristics, and appropriate guideline adjustments. In cases involving multiple participants, describe each participant's conduct and role in the offense.
- * Identify the number of employees directly involved in the offense and the degree of managerial involvement. Managerial involvement includes: facts regarding an individual(s) within high-level personnel who participated in, condoned, or was willfully ignorant of the offense; or pervasive tolerance of the offense by substantial authority personnel throughout the organization or unit of the organization (culpability score factors).
- * Describe any violation of a judicial order or injunction that occurred as a result of the commission of the offense (culpability score factor).
- * Note any other details of the offense behavior that may assist in understanding the offense.

- * If the defendant is a criminal purpose organization, include facts regarding the history and characteristics of the organization supporting this guideline determination.

Rationale. The description of the offense in this section of the report provides the court with the factual basis for application of the sentencing guidelines. The details pertaining to the offense(s) of conviction and all relevant conduct are included. The facts supporting determination of the base offense level, any specific offense characteristics or adjustments, and the culpability score factors are addressed. This section also provides the facts that support application of the guideline provision for Criminal Purpose Organizations. Any details that will assist the court in understanding the offense conduct are included so that the court will be able to make findings for the guideline application. The description of the offense will also assist the court in identifying factors that may be considered grounds for departure.

Victim Impact

- * Report all consequences of the offense conduct affecting any identifiable victim or the community.
- * Provide an assessment of the financial, social, psychological, and medical impact upon any individual victim of the offense.
- * Report any financial loss or impact caused by the conduct in the offense.
- * Describe the status of any related civil suits filed by victims that are pending or have been settled.
- * Report any remedial orders for corrective action that have been issued to the organization, including judicial, administrative, or civil orders.

Rationale. Rule 32(c) of the Federal Rules of Criminal Procedure requires that the presentence report address the consequences of the offense on any victim. By furnishing an account of this information in a separate section of the report, it is intended that the full impact on the victim(s) will be emphasized, regardless of whether the information affects guideline application. The status of civil suits and administrative actions is important in assessing the victim impact of organizational offenses.

Offense Behavior Not Part of Relevant Conduct (if applicable)

- * Describe criminal behavior related to the offense that is not considered relevant conduct, as defined by the guidelines, for guideline application.

Rationale. In some cases, the offense behavior of the count(s) to be dismissed is not considered part of relevant conduct (as defined by the guidelines). Since such behavior is not part of relevant conduct and is not included in the guideline application, the criminal conduct is included in this section rather than in The Offense Conduct. Discussion of the facts in this section makes it clear to the court that the conduct is not captured within the guideline application. For example, an organization pled guilty to one count of bid rigging; a count alleging tax evasion is to be dismissed. The conduct in the tax evasion would not be relevant conduct to the bid rigging conviction and would be presented in this section. Presentation of the information in this manner will assist the court in evaluating a plea agreement. There may also be instances in which related offense behavior that is not part of relevant conduct has not been included in the criminal charges. If sufficient evidence is present to establish that the conduct took place, it may be included in this section.

Obstruction of Justice

- * Describe any efforts by the defendant to impede the investigation, prosecution, or sentencing of this case (culpability score factor).

Rationale. This guideline adjustment is separated from The Offense Conduct because an assessment of the organization's obstruction conduct usually focuses on behavior occurring after law enforcement authorities have initiated an investigation. In general, evaluation of obstruction of justice is distinct from consideration of the offense conduct.

Self Reporting, Cooperation, and Acceptance of Responsibility

- * Identify whether or not the organization reported the offense to appropriate governmental authorities. Address whether the self reporting took place prior to an imminent threat of disclosure or government investigation. (culpability score factor)
- * Identify conduct, or lack thereof, demonstrating that the organizational defendant fully cooperated in the investigation and demonstrating a recognition and acceptance of responsibility for its criminal conduct (culpability score factor)

Rationale. In the same manner as the adjustment for obstruction of justice, this guideline adjustment is distinguished from The Offense Conduct because an assessment of the defendant's self reporting, cooperation and acceptance of responsibility usually focuses on behavior occurring after law enforcement authorities have initiated an investigation or have filed criminal charges. In

general, evaluation of these areas entails an assessment distinct from the presentation of the offense conduct.

PART B. PRIOR HISTORY OF MISCONDUCT

Similar Misconduct

- * List all similar incidents of misconduct, including criminal, civil, and administrative adjudications.
- * For each incident of similar misconduct list: the date of the charges (criminal, civil, or administrative charges); the charges of conviction or charges sustained; for criminal and civil cases list the date and court with the docket number; for administrative adjudications list the date of the action and the case identification number; for all actions, report the sentence imposed or action taken; report all pending matters that have been adjudicated but are awaiting disposition. Display applicable culpability score points (including zero).
- * Provide a brief description of the behavior underlying each incident of misconduct.
- * In criminal actions, address the status of representation of counsel.
- * If supervised on probation, describe the organization's performance.
- * Report probation revocations in the same entry as the original conviction or misconduct.

Rationale. Identification of similar misconduct with the dates of action facilitates application of the prior history portion of the culpability score.

Other Misconduct

- * List all other incidents of misconduct (that are not similar to the instant offense), including criminal, civil, and administrative adjudications.
- * For each incident of misconduct list: the date of the charges (criminal, civil, or administrative charges); the charges of conviction or charges sustained; for criminal and civil cases list the date and court with the docket number; for administrative adjudications list the date of the action and the case identification number; for all actions, report the sentence imposed or action taken; report all pending matters that have been adjudicated but are awaiting disposition.

- * Provide a brief description of the behavior underlying each incident of misconduct.
- * In criminal actions, address the status of representation of counsel.
- * If supervised on probation, describe the organization's performance.
- * Report probation revocations in the same entry as the original conviction or misconduct.

Rationale. Identification of prior misconduct that is dissimilar to the instant offense may be considered by the court as a factor that may warrant departure.

Pending Charges

- * Describe the status of any pending criminal, civil, or administrative charges.

Rationale. Identification of pending charges alleging misconduct provides facts that the court may consider in determining a sentence within the range or whether to depart and to what extent. Of particular importance, the court should be aware of pending civil cases that parallel the instant case in order to consider the potential for remedial orders, restitution, and other financial matters.

PART C. ORGANIZATIONAL CHARACTERISTICS

Organizational Data

Organizational data should include as much information as possible regarding the following:

- * When the organization was established or incorporated.
- * The location(s) of the business and description of the physical facilities.
- * The type of organization: public corporation; closely held corporation; subchapter S corporation; partnership; association; union; trust; non-profit organization, etc.
- * Identification of the owners of the organization and percentage of ownership.
- * Purpose of the organization and/or the nature of the business (including criminal purpose organization, if applicable).

- * General structure of the organization, including the number of employees, the hierarchical structure of the management, whether there are company subsidiaries or separately managed lines of business, and any history of acquisitions of other businesses and reorganizations.
- * Describe the present status of the organization in view of the criminal action, including:
 - impact of public knowledge of the offense on the organization's business or activities;
 - impact on the stock price;
 - debarment proceedings;
 - whether the organization is defunct;
 - projections of organizational recovery.

Rationale. Information regarding the history, growth, and future of the organization is of assistance to the court in applying the guidelines and in selecting appropriate sentencing options, particularly in determining the need for probation supervision as well as the length of the term and appropriate conditions. Such information is relevant in determining the defendant's ability to pay financial sanctions.

Effective Compliance and Ethics Program

- * Describe the organization's program to prevent and/or detect misconduct and the date of the policy, or the lack thereof.
- * Describe what, if any, efforts were taken to prevent and detect criminal conduct and promote an organizational culture that encouraged ethical conduct and a commitment to compliance with the law.

Rationale. Inclusion of the information in this section enables application of the culpability score factor for Effective Compliance and Ethics Program in cases in which the fine guidelines apply. In cases in which the fine guidelines do not apply, it may also be helpful to the court in analyzing whether the organization had an effective compliance and ethics program at the time of the offense. In addition, this information may be helpful in setting conditions of any term of probation ordered.

Financial Condition: Ability to Pay

- * Report the organization's assets, liabilities, equity, income, expenses, and the source of the information being reported.
- * Analyze the organization's ability to make a lump-sum restitution or fine payment and the organization's ability to make installment restitution or fine payments.

Rationale. A fine is the primary sanction for an organizational defendant. Payment of a fine and restitution are subject to the organizational defendant's ability to pay. Presentation of the organization's financial status is critical to provide the factual basis for the court's finding as to the organization's ability to pay financial sanctions.

PART D. GUIDELINE APPLICATION

- * Identify the edition of the *Guidelines Manual* used to apply the guidelines.
- * Using U.S.S.G. §8C2.1, determine whether counts are excluded from the fine provisions at §§8C2.2 - 8C2.9. If the guideline for the offense is not listed in §8C2.1, the Commission has not promulgated guidelines for setting fines for those offenses. For such offenses, do not apply §§8C2.2 - 8C2.9, and instead apply §8C2.10. Even if the offense is not listed in §8C2.10 and those fine provisions do not apply, the other sections of Chapter Eight are applicable (e.g., Probation)
- * Identify whether there is an agreement regarding the use of certain information pursuant to U.S.S.G. §1B1.8.
- * If there are multiple convictions, describe the factual basis for grouping decisions and cite the grouping rule(s). The explanation for grouping counts may be addressed before display of the application or immediately before the multiple count adjustment, whichever placement, given the facts of the case, will be more helpful in understanding the application.
- * Identify the Chapter Two guideline that determines the base offense level for each count or group of counts.
- * Display specific offense characteristics that apply to each count or group, and summarize the factual basis for resulting increases or decreases in the base offense level.
- * Apply any special instructions for base fine calculation within Chapter Two.

- * Display the Offense Level Computation and summarize the factual basis for:
 - Base Offense Level
 - Specific Offense Characteristics
 - Total Offense Level

- * Provide the base fine calculation by identifying:
 - Fine Table Amount
 - Pecuniary gain
 - Pecuniary loss
 - Apply Chapter Two special instructions, if applicable
 - Base Fine

- * Determine the Culpability Score Computation by displaying the culpability score factors and summarize the factual basis for the resulting increases or decreases in the base score for the factors:
 - Starting Culpability Score (See 8C2.5(a))
 - Involvement/Tolerance
 - Prior History
 - Violation of an Order
 - Obstruction of Justice
 - Effective Compliance and Ethics Program
 - Self Reporting/Cooperation/Acceptance of Responsibility
 - Total Culpability Score

- * Display the fine range computation stating:
 - Based on a culpability score of *** the minimum multiplier is *** and the maximum multiplier is ***. Given the base fine of ***, the guideline fine range is **** to ****.

- * Identify any applicable fine adjustments with a summary of the factual basis for:
 - Disgorgement
 - Fine Offset

- * Indicate whether the organization fits the criteria for being a Criminal Purpose Organization. The subheading for Criminal Purpose Organization appears in every report. If the provision applies, the officer provides a

synopsis of the facts and displays the net assets as defined in Application Note 1 of U.S.S.G. § 8C1.1. If the provision does not apply, display "not applicable" or N/A.

Rationale. This section presents the probation officer's application of the guidelines. A short synopsis of the facts underlying each application is included to provide tentative factual findings for the court. The provision for Criminal Purpose Organization is addressed in every report for two reasons: it communicates to the court that the provision has been considered by the officer, and, if the officer has applied the provision and the court then determines that it does not apply, the alternative guideline application is readily displayed.

PART E. SENTENCING OPTIONS

Restitution

- * Describe statutory provisions for restitution.
- * List guideline provisions applicable to the case.
- * Identify each victim and the amount of restitution outstanding.

Rationale. Listing the statutory provisions adjacent to the guideline provisions allows comparison of sentencing options that are statutorily available versus those that are available within the guidelines.

Fines

- * Identify statutory provisions applicable to any mandatory minimum and maximum fine for each count of conviction.
- * Report statutory provisions for special assessments for counts of conviction and the total amount for multiple-count cases.
- * List guideline provisions applicable to the case, including a determination of the fine range. *If a count of conviction has been excluded from U.S.S.G. §§ 8C2.2 - 8C2.9, a fine range will not have been determined. (See U.S.S.G. § 8C2.10).*

Rationale. Listing the statutory provisions adjacent to the guideline provisions allows comparison of sentencing options that are statutorily available versus those that are available within the guidelines.

Probation

- * Report statutory provisions applicable to the counts of conviction, eligibility for probation, authorized term, and mandatory conditions of supervision, if applicable.
- * State the guideline provisions applicable to the total offense level.

Rationale. Listing the statutory provisions adjacent to the guideline provisions allows comparison of sentencing options that are statutorily available versus those that are available within the guidelines.

Impact of the Plea Agreement

- * If the plea agreement includes counts to be dismissed, identify the counts to be dismissed and display the fine range that would have resulted if the defendant had been convicted on all counts.
- * Describe any mandatory minimum fine penalty or sentence enhancement that would have been required by the count(s) that will be dismissed.
- * If the plea agreement includes stipulations, or any other factor that may affect the guideline range, display the range that would have resulted if there had been no plea agreement.
- * Provide any other information regarding the plea agreement that is requested by the court.

Rationale. A description of the guideline range that would have resulted had there been no plea agreement assists the court in evaluating the impact of the plea agreement on the ultimate sentence. This section will only be included when the case includes a plea agreement.

PART F. FACTORS THAT MAY WARRANT DEPARTURE

- * Identify any factors that warrant consideration for departure from the guideline range.
- * Note that inclusion of a factor does not constitute a recommendation by the probation officer for a departure.

Rationale. Reporting all factors that the officer believes might be a consideration for departure serves two purposes: It provides notice to the court and to counsel

that the officer has considered each factor before making the sentencing recommendation, and it allows the court to independently consider each factor.

PART G. FACTORS THAT MAY WARRANT A SENTENCE OUTSIDE OF THE GUIDELINE SYSTEM

- * Identify any factors that warrant consideration of a sentence outside of the guideline system (i.e., any sentence authorized by statute, but not supported by the advisory guidelines or policy statements).
- * Note that inclusion of a factor does not constitute a recommendation by the probation officer for a departure.

Rationale. Reporting all factors that the officer believes might be a consideration for a sentence outside of the guideline system serves two purposes: It provides notice to the court and to counsel that the officer has considered each factor before making the sentencing recommendation, and it allows the court to independently consider each factor.

Addendum

- * Describe unresolved objections to the presentence report raised by the defendant, defense attorney, or the Government attorney.
- * Indicate whether the objections are based on disputed facts or legal arguments.
- * Report the probation officer's comments on the issues, with references, including statutory authority, sentencing guideline provisions, Supreme Court or circuit case law.

Rationale. The function of the addendum is to advise the court of the remaining disputed issues pertaining to the application of the guidelines and related sentencing matters, as well as to articulate the probation officer's position pertaining to those issues.

Sentencing Recommendation

- * As to each count, present the statutory and guideline provisions and recommended sentence in a chart format, including:
 - * Restitution
 - * Fine

- * Disgorgement
 - * Fine Offset
 - * Total Fine
 - * Special Assessment
 - * Probation
-
- * Provide a justification for the recommended sentence, including the need for special conditions of probation.
 - * Restate the recommended sentence, including special conditions of probation, using Model Sentencing Form language

Rationale. The sentencing chart allows the court to easily compare the recommendation to the statutory and guideline provisions. The justification provides the court with the officer's evaluation of the offense and the organizational defendant in order to support the recommended sentence. The justification includes references to the statutory objectives for sentencing to assist the court in providing a statement of reasons for imposition of the sentence. Displaying the recommendation in Model Sentencing Form language allows the court to adopt the recommendation in the appropriate language for the judgment.

Investigative Procedures and Gathering Information

Historically, probation officers have not had much experience completing organizational presentence reports. In 2003, only 200 organizational defendants were sentenced nationally, compared to 70,258 individual defendants.² Because preparation of organizational presentence reports has been a relatively rare task, the Probation System had not developed a format or standards for organizational presentence reports. Publication of Chapter Eight of the Sentencing Guidelines, "Sentencing an Organization," necessitated development of standards and a structure for the preparation of an organizational presentence report.

The guidelines for organizations pose new challenges to probation officers, who must not only interpret the guidelines, but also provide the court with the information necessary to support the officer's findings. Additionally, officers must provide the court with the same accurate and concise background information regarding an organization

² Source: U.S. Sentencing Commission.

that they provide for individual defendants. Since the primary punitive sentence that can be imposed on an organization is a fine, the greatest responsibility, if not challenge, is the determination of the organization's ability to pay the financial sanctions required by the guidelines. Probation officers are trained investigators; just as officers have developed the necessary skills and techniques to provide the court with an accurate and concise picture of an individual defendant's background, with training and experience, they can produce organizational reports of equal quality. In collecting and analyzing background information and financial records of organizations, officers rely on the same tested methods of investigation.

For preparation of many sections of the organizational presentence report, officers will rely on the same sources of information and verification techniques employed during the investigation of an individual defendant. For example, the sources of information for such sections as Charges and Convictions, The Offense Conduct, Victim Impact, and Sentencing Options will often be the same sources as for an individual defendant. However, there are certain areas of guideline application that are unique for organizations. Investigative procedures and methods of gathering information for an organization's prior history of misconduct and organizational characteristics will be discussed, as well as suggestions for determining the effectiveness of an organization's program to prevent and detect violations, commonly known as a compliance plan. Because of the importance of determining the ability of an organization to pay financial sanctions, techniques for gathering and analyzing the financial background of an organization will be discussed in detail.

PART B. HISTORY OF MISCONDUCT

The sources of information for an organization's prior history of misconduct include state and Federal civil and criminal court records, regulatory agencies, the assistant U.S. attorney, case agents, and, for public corporations, 10K reports filed with the Securities and Exchange Commission (10K reports will be described in detail below).

PART C. ORGANIZATIONAL CHARACTERISTICS

Organizations are not much different than individuals. Like people, they are born (or created) and have histories and lifestyles. The history of the organization is somewhat analogous to the biography of an individual defendant. The officer describes where and when the organization was formed, the type of organization, who created it, and how much investment or capital was provided. Pertinent questions that should be answered within the Organizational Characteristics section include: Who owns the organization and how much do they own? What is the purpose of the organization and the nature of its business? How did it evolve, i.e., what is the organization's developmental history? Does it have divisions or subsidiaries and, if so, what are the different business objectives of these separately managed profit centers? Discuss the structure of the organization, key officers, the composition of management, and the number of

employees. To assist in collecting this information, the Probation Form 1-B, Worksheet for Organizational Presentence Report, has been developed.

Interview

Many of the organizational characteristics can be obtained by interviewing the organization's representative. In most cases, the organization will be a rather small closely held corporation and the corporation's representative will be its president, owner, and often, its codefendant. It is important to conduct an interview with the representative as soon as possible and have this individual provide the necessary background information. It is desirable to schedule the interview at the organization's place of business because the representative will have access to records the officer will be requesting. In addition, an on-site inspection can be conducted.

Site Visit

A visit to the organization's place of business is essential. After learning about the nature of the business, take a tour with the representative. Ask for an explanation of activities and do not be timid about asking questions. Do your observations coincide with the nature of business as described by the organization's representative? Does it look like a legitimate business, i.e., if it is a retail store, does it have inventory? If it is a manufacturing firm, does the organization have the necessary personnel and equipment to manufacture? Observe the manufacturing process in action.

Effective Compliance and Ethics Program

In order to evaluate the effectiveness of an organization's program to prevent and detect violations of law, also known as a compliance plan, the officer requests information from the organization's representative, appropriate governmental authorities, and the case agents. Federal or state law enforcement, regulatory agencies, or program officials having jurisdiction over regulations applying to the organization may be of particular assistance in assessing whether a program is effective.

Some Basic Definitions

Any investigation of an organization will require the gathering of records to verify and expand information already provided on behalf of the organization. However, the type of records that are available for investigation largely depends on the nature of the organization.

An organization is "a person other than an individual." 18 U.S.C. § 18. The term includes corporations, partnerships, associations, joint-stock companies, unions, trusts, pension funds, unincorporated organizations, governments and political subdivisions

thereof, and non-profit organizations.³ Most organizations will fall into the categories of public or closely held corporations.

Corporation

A corporation is an entity legally separate from the persons owning it. Corporations are registered with state governments and their activities are regulated by law. A corporation is owned by its stockholders (also called shareholders), who hold stock or shares in the corporation. A corporation can own property, buy and sell, enter into contracts, borrow money, and take any other business action that an individual can take, subject to state law.

Articles of Incorporation

The organization's Articles of Incorporation may be useful to verify certain information provided by the organization's representative. The Articles will identify the officers of the company, the purpose of the company, and information about stock ownership.

Public Corporation (AKA: Open Corporation)

A public corporation is a corporation whose stock is available for sale to the public, subject to regulation by state and federal agencies. All public corporations are regulated by the Securities and Exchange Commission (SEC). Other state and Federal agencies may regulate a public corporation depending on the nature of the corporation's business. For example, a public corporation producing pharmaceuticals, such as Merck, Sharp, and Dome, is subject to regulation by the Federal Drug Administration. A public corporation providing telecommunications services, such as American Telephone and Telegraph (AT&T), is subject to regulation by the Federal Communications Commission. Public corporations file F-1120 tax forms.

Closely Held Corporations and Partnerships (AKA: Closed Corporations)

A corporation that is owned by a small group of people and whose stock is not available for sale to the general public.

Types of Closely Held Corporations

1. Incorporated Entities

A business entity that is legally separate from the individuals owning it. The owners who hold stock or shares in the corporation are known as

³ U.S.S.G. § 8A1.1, Application Note 1

stockholders or shareholders. Incorporated entities file F-1120 or F-1120A tax forms.

2. **Subchapter S Corporation**

A corporation that files a tax return but generally pays no taxes. Income is passed on to the owners who pay taxes on it as individuals, as in a partnership. Allows certain small businesses to enjoy the benefits of incorporation without the burden of double taxation. Subchapter S corporations file F-1120S tax forms.

Partnership

An unincorporated business that is owned by two or more individuals. Partnerships are either general or limited. In a general partnership, each of the partners has authority to participate in the management of the business. A limited partnership is one in which individuals may invest without actually taking part in the operation of the business. Interests in limited partnerships are sold much like stocks. Partnerships file F-1065 tax forms.

What to Request and Where to Obtain it

Once the type of organization has been determined, probation officers will find the records available that will provide important information.

Public Corporations

Although public corporations can pose complex investigative issues, i.e., subsidiaries, numerous business objectives, sophisticated management structure, intimidating financial statements, etc., the good news is they also provide the most in-depth and reliable background and financial information available. Some of the records will provide information that overlaps; however it is important to obtain as many of these items as possible for verification and comparison purposes. The more records that the officer obtains and reviews, the more comfortable the officer will be that the presentence report is as accurate as possible.

10K Report

A 10K is a report that public corporations are required to file annually with the Securities and Exchange Commission (SEC). Federal securities laws enacted in the 1930's established requirements for filing the 10K report requiring that it contain:

- corporate history/background
- organizational structure (subsidiaries, divisions)

- names of officers and board of directors
- background of key officers
- identity of significant stockholders
- where and when company was incorporated and where it now does business
- discussion of any significant current litigation
- discussion of any other significant legal issues, including indictment, bankruptcy
- audited financial statement

10K reports are the most reliable financial statements because they are filed under penalty of perjury. 10K reports will often include management's discussion of operations during the previous year and what they expect in the future. These are typically self-serving statements, not required by the SEC, nor scrutinized for accuracy. Such statements may be self-serving in that 10K reports are often submitted with loan applications. Nonetheless, these statements regarding the corporation's future projections are important since they are typically prepared prior to conviction and can be compared with what the corporation will represent about its future post-conviction.

10Q Reports

A 10Q is a quarterly filing with the SEC. A 10Q may provide more current information than a 10K, but they contain *unaudited information*. Accordingly, the information in a 10K is more reliable than the information in a 10Q.

Checklist for Public Corporation (Open Corporation)

* Documents containing financial statements.

What	Where⁴
1. U.S. corporate returns F-1120 for last 5 years (U.S. Corp. Tax Return)*	Corporate officer or IRS (IRS requires release)
2. 10 K's - filing that public corps must submit to SEC annually (5 years)*	Corporate officer or SEC
3. <u>Audited</u> financial statement*	Corporate officer or chief financial officer

⁴ The U.S. attorney and the investigating agents may have information regarding all of these areas.

4.	Annual reports (5 years)*	Corporate officer or state regulatory agency (e.g., comptroller, secretary of state)
5.	Price per share of stock	Business section of newspaper or library
6.	Reports from Standard and Poor's, Dunn and Bradstreet, and/or Moody's reports*	Public library
7.	Bankruptcy history	Bankruptcy court, corporate officer and 10K filings
8.	Company's current financial projections with assessment of impact of convictions on the business	Corporate officer and/or chief financial officer

Standard and Poor's, Dun and Bradstreet, and Moody's Reports

Standard and Poor's, Dun and Bradstreet, and Moody's are private companies that prepare reports containing descriptions of various, mostly public, corporations. Dun and Bradstreet provides reports of some very large private corporations. Although their reports differ in format, they typically contain corporate history, organizational structure, subsidiaries, number of employees, names of officers and Board of Directors, and two to five years of consolidated financial statements, and financial statements for the most recent quarters. These reports often analyze the financial health of a corporation using standard business ratios which will be discussed later.

The reports rate companies according to their present or forecasted general financial health. It may be beneficial to obtain several different reports on an organization. Moody's reports are particularly helpful because Moody's publishes separate manuals for industrial companies, banking and financial institutions, international companies, public utilities and municipalities and governments. While a Moody's report is often an excellent source for a description of the organizational structure of a company, including divisions and subsidiaries, a Standard and Poor's stock report often provides 10 years of financial statements on a company. Standard and Poor's stock reports are published every six months and, in the event there are significant financial developments in a company, more frequently. Therefore, a Moody's report and a Standard and Poor's stock report may provide complementary information on a company.

Annual Reports

Annual reports are the vehicle through which public corporations present themselves to their stockholders. They usually contain a succinct, audited financial statement, often simpler than the financial statement in a 10K report. In essence, annual reports are glorified 10K reports and contain self-serving projections. They are an excellent source of information.

Stock Price

The price per share of stock is available in the business section of the newspaper or in the public library. It may be instructive to compare the price of stock prior to the indictment with the current price to determine the effect the indictment and negative publicity associated with the prosecution has had on the company.

Closely Held Corporations

In contrast to a public corporation that generate public records, in completing the organizational data section on a closely held corporation or partnership, the probation officer must rely on the representations provided by the organization's representative. Occasionally, the assistant U.S. attorney, Government agents, or state or Federal regulatory agencies may be able to verify an provide additional background.

Checklist for Closely Held Corporation (Closed Corporation)

*Documents containing financial statements.

What	Where⁵
1. U.S. corporate tax return F-1120* or F-1120-S*; or U.S. partnership returns F-1065* for last 5 years	Corporate officer or IRS (IRS requires release)
2. <i>Audited</i> financial statement* (preferred) or compilation report (unaudited)*	Corporate officer or CPA

A compilation is an unaudited financial report.
For verification it may be necessary to request:

⁵ The U.S. attorney and the investigating agents may have information regarding all of these areas.

- | | |
|-----------------------------------------------------------------------------------------------------|--------------------------------------------------|
| a. bank records | Corporate officer or banks (with release) |
| b. business invoices | Corporate officer |
| c. real property records | Corporate officer or county/local records |
| 3. <i>Request information regarding:</i> | |
| a. outstanding judgments and/or liens | County or local public records |
| b. pending civil suits | Corporate officer or county records |
| c. contingent (future) assets and contingent liabilities | Corporate officer or county records |
| d. bankruptcy history | Bankruptcy court and/or corporate officer |
| 4. Financial statements filed with banks (filed for loans, line of credit, etc.)* | Corporate officer |
| 5. Company's current financial projections with assessment of impact of convictions on the business | Corporate officer and/or chief financial officer |

Financial Condition: Ability to Pay

Conducting financial investigations of organizations is a continual learning process. In each case, a probation officer has opportunities to learn more about corporate finances and techniques to investigate them. In general, businesses want to put "their best foot forward" in working with the court and will provide information upon request. It is therefore important to know what to ask for. The courts, prosecutors, and defense attorneys are aware that probation officers are usually not experts in the subject of corporate finance. Accordingly, if an officer does not understand something submitted by the organization's representative, it is important to ask for an explanation. This section is designed to provide assistance in understanding basic concepts of corporate financial statements, direction in knowing what to ask for, and guidance in knowing what to do with the information upon receipt. As with any new complex responsibility undertaken by probation officers, such as sentencing guidelines, case law, or electronic monitoring, the process becomes easier with experience, but there will always be something new to learn. In this section, the process for determining an organization's

ability to pay financial sanctions will be presented. However, for more detail, officers are referred to the *Financial Investigation: Desk Reference for U.S. Probation and Pretrial Services Officers*, published by the Federal Judicial Center as part of a training curriculum.

In the Financial Condition: Ability to Pay section of the report, the goal is to determine an organization's ability to pay restitution and a fine. The officer conducts an investigation of the organization's financial condition and provides a summary in a manner that will be easy for the court and attorneys to review and understand.

A financial investigation is not a static assessment; rather it is a process of incorporating an assessment over time. Organizations have financial histories and lifestyles. It is more accurate to assess and predict an organization's ability to pay by analyzing data over time. An accurate assessment of ability to pay is not a snapshot of the organization's current financial picture. It is more like a movie in which conditions and fortunes may change over time.

In assessing the ability of an organization to pay restitution and/or a fine, it is important to obtain financial records for several years. Unlike assessing the financial condition of an individual defendant, the current financial profile of an organization may not portray an accurate picture of the organization's ability to pay. Looking at the history of a company or organization will be of value in predicting the financial health of the organization in the future. For example, if an officer is evaluating a company that is currently not making much profit because the criminal prosecution has resulted in negative publicity and the value of the stock has dropped, it would be instructive to know that for the past three years the company has made large profits. In such a circumstance, the officer would consider whether the company's profits have a strong potential for recovery in the future. Conversely, an officer may receive a current financial statement from a company suggesting that it could pay a large fine over time. However, an assessment of the past three years shows indications that the company's solvency has been diminishing at an increasing rate each year and may indicate that the company is headed toward bankruptcy. Accordingly, it is preferable to obtain financial documents for the past three to five years.

The key element of any financial investigation is to obtain and analyze the organization's financial statements. Financial statements are needed to determine if the organization has the ability to pay financial sanctions. Many of the items that appear on the checklists above are marked with an (*), indicating they provide financial statements.

The most reliable financial statements for a public corporation are the 10K and the 1120 tax returns since both are submitted under penalty of law. Remember to request three to five years of financial statements to assist in analyzing the organization's financial history.

Types of Financial Statements

Although financial statements prepared by Certified Public Accountants (CPAs) all follow the same general format, they are prepared with different degrees of thoroughness. It is important to be able to recognize the standard types, to know how they are prepared, and to understand how much you can rely on each of them.

Compilation Report

The compilation report is the quickest and least expensive kind of statement to prepare. As the name suggests, all the accountant does is take the figures provided by his client and arrange them into a standard format. Accountants offer no independent assurance about the reliability of the figures since they have done nothing more than compile them. The report should include a brief disclaimer explaining this fact. Compilations can look very authentic and impressive but have little value for verification purposes. Without further investigation, the probation officer has no way of knowing whether the defendant simply made up the figures that were provided to the accountant. To verify the information, it may be helpful to request copies of bank records and/or inspect the books, invoices, accounts payable, and accounts receivable.

Review Report

The review report is only slightly more reliable. In preparing this statement, the accountant also asks the client about his record keeping procedures and how he arrived at his figures. The accountant then makes a limited analysis to see if the figures seem consistent with what the client told him. The report should include a statement similar to that found in the compilation.

Audited Financial Statement

The audited financial statement is by far the most reliable. Theoretically, all of the information in the statement has been verified by independent auditors following a strict set of rules. Auditors verify the financial records, observe inventory, send letters to customers, creditors and lending institutions to verify the company's financial transactions. The CPA attaches a statement to the audited financial statement certifying that it has been prepared using proper accounting methods and that it accurately represents the financial condition of the business. The officer can generally rely on the accuracy of information contained in an audited financial statement. In actuality, the officer is relying on the integrity of the CPA that prepared the audited statement.

Financial Statement Filed With Banks

On occasion, there may be value in obtaining copies of financial statements that an organization has filed with banks. These are commonly filed with loan applications and applications for lines of credit. Such financial statements provide a profile of the organization at a certain point in time.

Requesting Copies of Tax Returns

In requesting organizations to provide copies of tax returns, there are a few considerations to keep in mind. A corporation with subsidiaries may file separate returns for the subsidiaries or may file a "consolidated" tax return that includes the subsidiaries. The decision regarding how to file the returns will depend upon the tax considerations and which method would be most beneficial to the company. Thus, when asking for copies of tax returns, the probation officer should inquire about subsidiaries and ask whether the company files a consolidated return.

Remember that organizational tax returns are financial statements. Income or the profit/loss statement is on the front page and the balance sheet is on Schedule L of the return. Some corporate returns are voluminous because of the extensive backup information that is submitted with the return. In all circumstances, the officer should request copies of the IRS forms (F-1120, F-1120-S, or F-1065) and the schedules (IRS required addendums).

Corporations are rarely indicted alone. Corporate defendants often have corporate officers charged as individual codefendants. In such a case, the probation officer also requests copies of the F-1040 tax returns (individual tax returns) regarding the codefendant corporate officers. The probation officer will be able to examine the corporate returns and the individual returns to see how compensation flowed from the corporation to the individual. Obviously, compensation paid as wages should be reflected in the individual's W-2 income statement. Director fees paid to a corporate officer, a form of compensation that is not considered wages, are typically reported on a F-1099 report. By obtaining the tax returns for both the company and the individual defendants, the probation officer will be able to examine the flow of funds. In doing so the officer may discover discrepancies. In comparing the returns, it is important to be aware that while individuals are required to file their tax returns on the basis of the calendar year, organizations may define a fiscal year for the time frame covered in their tax returns based upon their accounting procedures. Accordingly, the figures transferred from a corporate return to an individual return may not be consistent if the time frames differ.

Bankruptcy History

When an organization files for bankruptcy, it is required to file a financial statement under penalty of perjury, including the company's net worth. A bankruptcy file, whether it is an old file or a current file, will pinpoint the financial condition of an organization at a given point in time. If the company is currently undergoing bankruptcy proceedings, the officer contacts the trustee in order to determine the feasibility of collecting restitution and a fine.

A filing under Chapter 11 is a request for temporary protection from creditors with the intention to reorganize, pay creditors, and continue operations. A filing under Chapter 7 is indicative of an organization's intent to liquidate available assets, pay creditors, and cease business operations. On occasion, Chapter 11 protection may serve as a prelude to the filing of a Chapter 7.

Financial Projections

Ask the individual presenting the organization for a statement of the company's projections for the future, including an assessment of the impact of the conviction(s) on the organization. Such projections will be helpful in several ways. The officer can compare what the organization is stating now with what the organization previously represented to the public in its annual reports and 10K reports. Projections will also assist in evaluating the future financial health of the organization. It is important to inquire about contingent (future) assets and contingent liabilities. For example, a pending major contract that will bring substantial funds to the company is an example of a contingent asset. An example of a contingent liability is when a company will be entering into a legal settlement in the near future and the financial plan must allow for payment. Another example is a company that must retool in the next six months. Requesting a statement from the organization regarding its financial projections is also a good procedure in that the officer is, in essence, providing the organization the opportunity to provide its statement as to ability to pay.

What do you do with the information?

In order to understand the documents, definitions of a financial statement and the contents are provided below and clarifying comments follow in italics.

Financial Statement

A financial statement is a formal report prepared by an accountant, reflecting the financial condition of a business. It includes a balance sheet, an income or profit and loss statement, and possibly other tables reflecting changes in the financial condition of the business. Financial statements are the basic tools for both collecting and presenting

financial information. It is essential to be able to use them effectively in analyzing the ability of an organization to pay restitution and fines.

Balance Sheet

A balance sheet is a formal report prepared by an accountant reflecting the assets, liabilities, and owner's equity in a company on a specific date.

Assets

An asset is something that is owned and has value (can be sold). *A liquid asset is one that can be converted to cash. In a balance sheet format, assets are listed in order of their relative liquidity, with the most liquid assets appearing first.*

current assets

Current assets include cash and those assets (accounts receivable and inventory) which the organization expects will be turned into cash within a year. *Current assets are used by the organization to pay its current liabilities. Current assets may also be the source for immediate payment of financial sanctions.*

fixed assets

Fixed assets include assets not intended for sale that are used to manufacture the product, display it, warehouse it, or transport it. Examples include land, buildings, machinery, equipment, furniture, automobiles and trucks. *A financial statement will conservatively display the value of an organization's fixed assets, listing them at purchase price less accumulated depreciation. The value listed on the balance sheet may not have any correlation to fair market value. Fixed assets are often not useful as a source for immediate payment of a fine or restitution since they are necessary for the continued operation of the company.*

other assets

Other assets include any other property with perceived value, often including intangibles (e.g, a trademark, a logo, goodwill, or a patent). *These assets are generally the least readily available to convert to cash.*

Liabilities

A liability is money owed to another; a debt. *A liability is a creditor's claim against assets.*

current liabilities

Current liabilities include accounts payable and other debts due within a year.

long term liabilities

Long term liabilities are debts that are not expected to be paid or satisfied within one year. *Long term debt is generally secured against a specific asset. Long term liabilities are generally used to finance the purchase of fixed assets.*

Stockholders' Equity

Stockholder's equity is the net worth of the organization and represents the collective owners' claim against the assets. Stockholders' equity consists of capital stock, capital surplus, and accumulated retained earnings.

capital stock

Capital stock represents ownership of a corporation, as evidenced by a stock certificate. A corporation's stock is divided into a specified number of shares.

capital surplus

Capital surplus is any monies received by the organization from the sale of stock which is in excess of the stock's par value. Par value is a specified amount printed on the face of a stock certificate; not to be confused with market value. The difference between par value and market value is designated as capital surplus on a balance sheet.

accumulated retained earnings

After payment of dividends, accumulated retained earnings represent the yearly profit or loss which is held by the organization and which accumulates over time.

Income Statement (profit and loss statement)

Also known as a Profit and Loss Statement, the Income Statement is a formal report prepared by an accountant reflecting the income, expenses, and net profit of a business over a specified period of time. The income statement displays the cash flow of the organization; **sufficient cash flow may provide a source for payment of financial sanctions over time.**

gross receipts

Gross receipts represent the primary source of money received by the organization from its customers for goods sold or services rendered.

cost of goods sold (adjustment to income)

Cost of goods sold include the costs of manufacturing, producing, and delivering goods and services sold.

gross profit

Gross profit is the difference between the gross receipts and the cost of goods sold.

other income

Other income includes all other sources of income not directly related to the nature of the business.

total income (revenue)

Total income represents the gross profit plus other income.

expenses

Expenses are costs incurred by an organization to conduct its day to day operation. *Expenses are not to be confused with liabilities.*

net profit

Net profit is total income minus expenses, costs, and tax obligations. *It is important to remember that the tax liability in Subchapter S corporations and partnerships becomes the*

responsibility of their owner(s) and is transferred to the individual's tax return (F-1040).

Formatting the Information

The officer examines the information in the documents looking for consistency. The officer then selects the source with the most reliable information to look for financial patterns. When comparing the figures, an effective method is to take the financial statements from the same source (e.g., tax filings) for several years and compare the figures by laying them out on one page. The financial condition on the following page exhibits a format for plotting the information.

BALANCE SHEET				
	1990	1989	1988	1987
ASSETS				
Cash	\$ 43,737	\$ 116,522	\$ 479,512	\$ 330,857
Accounts Receivable	896,060	943,229	1,051,516	1,407,758
Inventory	393,000	375,000	400,000	569,200
Other Current Assets	61,978	75,818	214,126	191,435
Loans to Shareholders	520,000	180,000	80,000	50,000
Fixed Assets less depreciation	5,955,606	4,483,119	4,977,238	5,598,180
Other Assets	3,700	3,700	3,700	3,700
TOTAL ASSETS	7,874,081	6,177,388	7,206,092	7,151,130
LIABILITIES				
Accounts Payable	619,520	538,729	347,704	292,689
Mortgages, Notes	462,731	315,482	223,182	399,892
Other Current Liabilities	73,119	104,010	508,003	499,794
Long Term Liabilities	5,603,129	4,277,890	1,357,720	1,726,115
TOTAL LIABILITIES	6,758,499	5,236,111	2,436,609	2,918,490
EQUITY				
Stock	1,000	1,000	1,000	1,000
Paid-in Capital	1,298,566	1,321,739	2,672,208	3,334,367
Retained Earnings	(183,984)	(381,516)	2,096,275	1,897,273
TOTAL EQUITY	1,115,582	941,277	4,769,483	5,232,640
TOTAL LIABILITIES & EQUITY	\$7,874,081	\$6,177,388	\$7,206,092	\$8,151,130

PROFIT/LOSS

INCOME

Gross Sales	\$8,171,714	\$3,853,417	\$8,137,317	\$8,035,990
Cost of Goods	5,471,207	4,364,730	6,376,090	5,534,339
Gross Profit	2,700,507	(511,313)	1,761,227	2,501,651
Other Income	195,884	218,204	900,195	153,300
Total Income	2,896,391	(293,109)	2,661,422	2,654,951

EXPENSES

Compensation to Officers (Wages)	73,850	80,000	80,000	83,077
Rents	124,791	350,454	447,415	407,236
Interest	1,157,800	1,045,738	1,016,740	799,163
Depreciation	768,906	618,704	179,135	153,302
Other Deductions	52,444	59,738	62,314	93,526
Total Deductions	521,068	432,285	574,300	345,788
Taxable Income	2,698,859	2,586,919	2,359,904	1,882,092
Tax	197,532	(2,880,028)	301,518	772,859
	0	(401,237)	102,516	298,721
Net Income	197,532	(2,477,791)	199,002	474,138

Analyzing the Financial Information

In examining the financial statements for several years, the officer is looking for patterns of growth and decline. In determining the ability of an organization to pay financial sanctions, it is important to be able to assess the quality of a business. Is it healthy? Is it just holding its own? Or is it heading toward bankruptcy? Is it a legitimate, income-producing activity or simply a "front" or "cover" used to conceal other sources of income? These questions can be answered by analyzing the financial statement using certain standard formulas. These formulas, known as "key business ratios," are used to measure how solvent and how profitable a business is:

Name	Formula	Comments
1. Current Ratio	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$	A measure of working capital. The higher the ratio, the higher the probability that the business will be able to meet its short-term obligations to creditors. A ratio of 2.0 is normally considered healthy, although ratios as low as 1.5 can be acceptable in some cases.

Name	Formula	Comments
2. Quick Ratio	$\frac{\text{Cash} + \text{Receivables}}{\text{Current Liabilities}}$	Another measure of solvency. It indicates the ability to meet short-term obligations without selling inventory, which might be overvalued or hard to move. A ratio of 1.0 or better indicates a <i>liquid</i> business.
3. Total Liabilities to Net Worth	$\frac{\text{Total Liabilities}}{\text{Net Worth}}$	A final measure of solvency. It should generally be less than 100%, otherwise the creditors have more of a stake in the business than the owners. The lower the percentage the better. A very high percentage usually indicates approaching bankruptcy.
4. Return on Sales (Profit Margin)	$\frac{\text{Net Profit}}{\text{Net Sales}}$	Varies depending on type of business. Compare to the industry norms discussed below for the type of business involved.
5. Return on Net Worth	$\frac{\text{Net Profit}}{\text{Net Worth}}$	A second measure of Net Worth profitability Net Worth indicating the return owners received on their investment. A ratio of 10% is usually considered good. Compare the return to what the owners could have received by simply putting their money in the bank or selecting other investments requiring no effort on their part.

The desirable ratios given above are a general guide. The ratios for an organization can be compared to those for similar businesses nationwide. Dun and Bradstreet, Inc., is a commercial credit reporting agency that maintains these statistics and publishes them in a booklet entitled "Industry Norms and Key Business Ratios," which is available at the public library.

Once you have a financial statement, it is a simple matter to compute the ratios and compare them to the general standards and industry norms. Significant irregularities should be explored through further questioning of the organization's representatives. Unexplained irregularities may indicate that the business is in trouble or that it is not intended to make a profit (a common situation with a "front" or "cover" criminal organization and warrants further investigation). By displaying the financial statement information on an organization for several years, the probation officer can calculate the ratios and look for trends in growth, solvency, and profitability.

Some Additional Tips in Analyzing Financial Information

In assessing general trends of growth and decline over time, it may be helpful to look for:

Growth: Look for a rise in assets and decline in liabilities. The end product would be an increase in the stockholders' equity.

Expansion: Look for a growth in assets and similar growth in liabilities (because the organization is borrowing more money to expand) and little change in equity. The assets must equal liabilities plus net worth. Ask what the expected outcome of the expansion will be. Does the organization forecast a change in sales? Obviously an expected increase in sales may improve the organization's ability to pay financial sanctions in the future. If an organization is in the process of expansion, we may need to look to the future for full payment of restitution and a fine.

Liquid Assets: Liquid assets include cash and those assets that can be quickly converted into cash. **Liquid assets will provide the basis for immediate payment of financial sanctions.**

Fixed Assets and Depreciation: The fixed assets are used by the organization to conduct business and typically include land, buildings, equipment, etc. If the organization asserts that it must replace equipment to remain solvent, look to see if the equipment has been depreciated in value. Capital outlay for purchase of equipment may reduce liquid assets and the ability of the organization to make a lump sum payment at sentencing. An assessment should be made as to whether or not the organization needs the new equipment to remain solvent. If the company is out of business, it may not be able to pay full restitution and a fine.

Loans to Stockholders (bleeding the corporation): A method to bleed money from a corporation is to make loans to the stockholders. The loans become assets of the company, but stockholders' equity (the value of the business) may have less value than represented. Bleeding money from the company may indicate a criminal organization. If an organization is not solvent but large amounts of money have been diverted to a principal officer who is also charged criminally, it may be appropriate to fine that individual with the amount the corporation would have been required to pay. If the money from the company is diverted to a principal officer year after year, the company may be a shell or alter ego of that principal officer.

Money Laundering: If large amounts of money are coming into the corporation from stockholders and the company is cash rich, look to see where the money is going. Sometimes laundered money will be hidden as a mortgage. If the mortgage is not secured with collateral, such a situation flags the potential for money laundering. A mortgage implies the purchase of an asset. Since mortgages must be filed with local

authorities, check the mortgage if the situation looks suspicious. Money coming into a corporation from stockholders that is subsequently returned to stockholders as loans may indicate money laundering.

Sample Analysis of an Organization's Financial Statements

On the next page is the financial condition of a company that was previously displayed to demonstrate a method to format the information from financial statements. The following analysis was developed by comparing the company's financial statements for four years, looking for trends and using the standard business ratios.

Analysis: This table represents the company's consolidated financial statement for years 1987 through 1990. Assembling the accounts for several years on a single sheet of paper allows the probation officer to look for trends, as well as identify red flags (i.e., unusual entries or drastic changes) that require further explanation by the company's representative or accountant.

The two most important components to the financial statement are the balance sheet and the income statement. The balance sheet is always presented first and the most current year is always presented in the far left column.

Typically, we look to the balance sheet for an immediate fine payment. Assets are listed in order of liquidity. First, we look to cash. This is not a cash rich company.

The Accounts Receivables appear substantial. The company may be able to secure a loan against them and use the money to pay a fine.

Look at the Loans to Shareholders account, which increased \$340,000 in 1990. Notice the increase to this account and the decrease to the cash account in the same year. If you can collect it from the shareholder, use it to pay a fine. If the shareholder is a codefendant and cannot pay, the company's equity is only half of what it now represents.

When the Fixed Assets account is quickly depreciated, it may be indicative of a company that may argue that they need to retool. That is not the case with this company. Fixed Assets and Long Term Liabilities both rose proportionally in 1990. Remember that Long Term Liabilities are typically the source to finance fixed assets.

Notice the negative retained earnings in 1989 and 1990 as compared to 1987 and 1988. Look at the Gross Profit and negative Taxable Income in 1989. Something happened to the company in 1989 (red flag) and the probation officer needs to look into this. However, notice how sales rebounded in 1990 to pre-1989 levels and the company was again profitable. Remember to look at the Income Statement when determining if the company can pay a fine over time.

BALANCE SHEET

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Cash	\$ 43,737	\$ 116,522	\$ 479,512	\$ 330,857
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Other Current Liabilities	73,119	104,010	508,003	499,794
Long Term Liabilities	5,603,129	4,277,890	1,357,720	1,726,115
TOTAL LIABILITIES	6,758,499	5,236,111	2,436,609	2,918,490
EQUITY				
Stock	1,000	1,000	1,000	1,000
Paid-in Capital	1,298,566	1,321,739	2,672,208	3,334,367
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TOTAL EQUITY	1,115,582	941,277	4,769,483	5,232,640
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PROFIT/LOSS				
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Other Income	195,884	218,204	900,195	153,300
Total Income	2,896,391	(293,109)	2,661,422	2,654,951
EXPENSES				
Compensation to Officers (Wages)	73,850	80,000	80,000	83,077
Rents	124,791	350,454	447,415	407,236
Interest	1,157,800	1,045,738	1,016,740	799,163
Depreciation	768,906	618,704	179,135	153,302
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	0	(401,237)	102,516	298,721
Net Income	197,532	(2,477,791)	199,002	474,138

Remember that current ratios of 2.0 are normally considered healthy and 1.5 can be acceptable in some cases. (Current ratio = current assets divided by current liabilities). Our company had a current ratio of 1.21 in 1990 and 1.58 in 1989. Red Flag: If you can convert the \$520,000 from the shareholders into cash, you will increase the current assets, which then increases the current ratio to a more healthy 1.66 for 1990.

Remember that quick ratios of 1.0 are normally considered healthy. (Quick ratio = cash + receivables divided by current liabilities). Our company has a quick ratio of .81 for 1990 and 1.11 for 1989. Reg Flag: If you can collect the \$520,000 shareholder loan, you would increase the cash and the quick ratio to a healthy 1.26.

The primary questions for the probation officer are: How much can this company realistically pay? — and — Where will it come from?

Our best source to obtain a fine payment in a lump sum rests in the ability to convert the loans to shareholders to cash (in other words, collect the loans from the shareholders). There is a potential lump sum payment of \$520,000.

If that is not possible, the company only has the ability to make a much smaller, immediate payment (perhaps \$50,000). Since the company returned to profitability in 1990, it should be able to make fine payments over time (perhaps \$100,000 annually).

Sources of Financial Information		
Source	Information	Records
Internal Revenue Service	<ul style="list-style-type: none"> • Taxable income • Assets • Liabilities • Expenditures • Detailed accounting on self-employment • Previous employers 	<ul style="list-style-type: none"> • F-1120, • F-1120A, • F-1120S, • F-1065, all with schedules
Bank Records	<ul style="list-style-type: none"> • Income (deposits) • Expenses (checks & withdrawals) • Hidden assets • Associates • Unreported transactions 	<ul style="list-style-type: none"> • Statements • Canceled checks • Microfilm copies (from bank)

Sources of Financial Information		
Source	Information	Records
County Recorders	<ul style="list-style-type: none"> • Real estate transactions <ul style="list-style-type: none"> ▸ date purchased/sold ▸ to/from whom ▸ price ▸ amount financed ▸ monthly payment (or payoffs) ▸ claims by or against subject • Lawsuits • Income tax problems 	<ul style="list-style-type: none"> • Deeds • Mortgages • Liens • Judgments • Satisfactions • Other instruments relative to ownership • Transfer of encumbrance
County Tax Assessor	<ul style="list-style-type: none"> • Property owned • Address or legal description • Dimensions • Improvements • Date of purchase • Name(s) of owner(s) • Address(es) of owner(s) • Assessed value • Taxes paid or due • Delinquent taxes • Former owners 	<ul style="list-style-type: none"> • Indexes <ul style="list-style-type: none"> ▸ Name ▸ Legal description ▸ Address
Court Clerk – Civil County & Federal	<ul style="list-style-type: none"> • Allegations concerning financial transaction • Financial statements • Affidavits • Depositions • Stipulations • Agreements • Settlements • Copies of instruments & documents 	<ul style="list-style-type: none"> • Civil suits • Bankruptcy files
Fictitious Name Register County Courthouse	<ul style="list-style-type: none"> • Ownership of DBAs (doing business as) • Time in business 	<ul style="list-style-type: none"> • Indexes • Affidavits

Sources of Financial Information		
Source	Information	Records
Occupational License Bureaus – County & City	<ul style="list-style-type: none"> • Ownership • Time in business 	Original application
Better Business Bureau	<ul style="list-style-type: none"> • Unreported transactions • Potential witnesses or sources of information 	Consumer complaints
Securities and Exchange Commission (SEC)	<ul style="list-style-type: none"> • 10K reports • Licensing 	<ul style="list-style-type: none"> • Licensing records • Violator files
Federal Trade Commission (FTC); Commodities and Futures Trading Commission (CFTC); or State Securities Agency	<ul style="list-style-type: none"> • Civil & Criminal enforcements 	
Occupational Regulation Agencies	<ul style="list-style-type: none"> • Ownership • Time in business • Disciplinary actions 	Licensing records
Department of Motor Vehicles	Vehicles owned by organization	Title records
Newspaper, Library, or Morgue	Leads for further investigation	Newspaper articles
Bureau of Unemployment Compensation	<ul style="list-style-type: none"> • Compensation received • Payment of taxes by organization 	<ul style="list-style-type: none"> • Compensation records • Employer contribution records