NEW JERSEY
BUSINESS
A Publication of the New Jersey Business & Industry Association

Getting to the Root of Ponzi Schemes

By Timothy J. King, CPA, Bederson & Company LLP

It is universally agreed that Ponzi schemes are criminal enterprises from their inception. As a forensic professional currently working on multiple Ponzi cases, I concur. This certainly holds true for the fraudsters of our time and is aptly underscored by the architect of the original Ponzi scheme, Charles Ponzi.

During the 1920s, Ponzi set up shop in Boston with no money of his own and nefarious intent to defraud investors. He promised a 50-percent profit in 45 days through an obscure investment involving overseas postal coupons. The initial investors made money, which allowed Ponzi to attract others. He was eventually identified as a fraud by a Boston newspaper and his criminal record in Canada was well publicized.

The same dynamics apply in one of my current cases. Here, the alleged perpetrator was a prominent real estate investor who had built an impressive reputation in the

Timothy J. King:
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reputation grew, banks hastily granted him loans. Many bypassed mortgage and title paperwork to do so. After the fraudster was caught and had to file bankruptcy, we had an initial meeting with his controller. In a preliminary attempt to determine the estimated equity in the properties, we reviewed the Schedules of Liabilities and Assets included with the bankruptcy petition and matched the mortgages with the collateral. After completing this procedure, we were left with four mortgages but no remaining properties. We questioned the controller who attributed the inconsistency to a clerical error. The disquiet and abasement of the bank was justified, as they realized they held mortgages on properties not owned by the borrower.

Due to media exposure of Ponzi schemers such as Bernie Madoff, we may get the impression that they target high net-worth individuals when, in fact, investors from many income levels fall for these scams. In fact, investors with fewer resources are easier victims because they are less equipped to defend themselves once they discover the scam. Many Ponzi schemes share common characteristics. The Securities and Exchange Commission (SEC) has identified these warning signs:

- Consistent returns despite periods of great market volatility.
- High investment returns with little or no risk.
- Investments have not been registered with the SEC or state regulators.

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- Investment professionals and their firms are not licensed or registered.
- Have difficulty obtaining and reviewing information about the firm or investments.
- Don't receive a payment or have difficulty cashing out your investment.
- Don't really know where your money is being kept.

Generally, if an investment sounds too good to be true, it usually is. To prevent falling victim to a Ponzi scheme, it is critical to research a potential financial advisor and carefully read any investment's prospectus or disclosure statement. If you feel that you have become involved in a Ponzi scheme, attempt to withdraw your funds immediately and contact a forensic accountant and/or an attorney, if necessary.

Timothy J. King, CPA, CFF, CFE, is a Partner at Bederson & Company LLP in West Orange. He is also a member of the New Jersey Society of CPAs. Contact King at tking@