PRINCIPLES OF FRAUD EXAMINATION

FOURTH EDITION

JOSEPH T. WELLS

WILEY

PRINCIPLES OF
FRAUD EXAMINATION

PRINCIPLES OF FRAUD EXAMINATION

FOURTH EDITION

JOSEPH T. WELLS, CFE, CPA

WILEY

VICE PRESIDENT AND PUBLISHER	George Hoffman
EXECUTIVE EDITOR	Joel Hollenbeck
CONTENT EDITOR	Brian Kamins
EDITORIAL ASSISTANT	Rebecca Costantini
Sr. MARKETING MANAGER	Karolina Zarychta Honsa
SENIOR PRODUCTION MANAGER	Janis Soo
ASSOCIATE PRODUCTION MANAGER	Joel Balbin
PRODUCTION EDITOR	Eugenia Lee
COVER DESIGNER	Kenji Ngieng
COVER PHOTO	© Thinkstock/iStock

This book was set in 10/12pt TimesLTStd by Laserwords Private Limited, Chennai, India and printed and bound by Courier Kendallville. The cover was printed by Courier Kendallville.

This book is printed on acid free paper.

Founded in 1807, John Wiley & Sons, Inc. has been a valued source of knowledge and understanding for more than 200 years, helping people around the world meet their needs and fulfill their aspirations. Our company is built on a foundation of principles that include responsibility to the communities we serve and where we live and work. In 2008, we launched a Corporate Citizenship Initiative, a global effort to address the environmental, social, economic, and ethical challenges we face in our business. Among the issues we are addressing are carbon impact, paper specifications and procurement, ethical conduct within our business and among our vendors, and community and charitable support. For more information, please visit our website: www.wiley.com/go/citizenship.

To order books or for customer service, please call 1-800-CALL WILEY (225-5945).

ISBN-13: 978-1-118-92234-7 (pbk.)

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1

To the memory of my father,
Coyle A. Wells (1906–1962),
and my mother,
Vola D. Wells (1910–1990).

FOREWORD

It is a pleasure to write the foreword for *Principles of Fraud Examination*, a book authored by my friend, Dr. Joseph T. Wells. I have known Joe for over 20 years. While most students, practitioners, and academics know him as the founder and chairman of the Association of Certified Fraud Examiners, I know Joe as a friend, as one who has influenced my thinking, knowledge, and research about fraud, and as a person who is one of the most thorough, ambitious, and thoughtful fraud researchers I have ever met. And, as you will see from reading this book, Dr. Wells is an excellent communicator who can make numerous fraud theories and schemes easy to understand.

Joe is a prolific writer. For several years, he authored a fraud-related article in nearly every issue of the *Journal of Accountancy*, and he has written many other books and articles. Dr. Wells' work has won numerous awards. He has also written and produced more than a dozen fraud-related videos that are an integral part of nearly every accounting, auditing, and fraud curriculum in the United States.

It is my opinion that Joseph T. Wells has made a greater contribution to the prevention, detection, and investigation of fraud than any person in the world. Because of his work in fraud education and research and his vision in organizing the ACFE, there are tens of thousands of people who have a better understanding of fraud and who are working to reduce its cost and occurrence.

Principles of Fraud Examination provides an excellent description of the behavioral and social factors that motivate occupational offenders. It also provides an analysis and taxonomy of various kinds of frauds and cases that illustrate and help readers understand each type of fraud. The concepts described in the book are sound and are based on the most extensive empirical research ever conducted on the subject. This book is a must read for any student interested in the study of fraud.

Reading *Principles of Fraud Examination* will help you better understand the various ways fraud and occupational abuse occur, thus helping you identify exposures to loss and appropriate prevention, detection, and investigation approaches. And, as you will see, the book is written in a way that will capture and hold your attention. The numerous fraud stories and personal insights provided by Joe will have you believing you are reading for enjoyment, while in fact, you will be learning from one of the true master educators. I believe this book is destined to become one of the real classics and definitive works on the subject of fraud.

W. Steve Albrecht, PhD
Brigham Young University

PREFACE

The numerous headline-grabbing accounting scandals of recent years—Enron, WorldCom, Tyco, HealthSouth, Bernie Madoff, Lehman Brothers, and Olympus, among others—would be reason enough to study the serious issue of fraud. But the methods used in these cases are not new; they are merely variations of tried-and-true scams.

Pliny the Elder first wrote of fraud over two thousand years ago when he described the adulteration of wine by crooked merchants in Rome. Since that time, fraud has become an increasingly serious issue. Now, in the information age, it can threaten the very underpinnings of our economy.

Accountants have historically had an important role in the detection and deterrence of fraud. But fraud, as you will read in the following pages, is much more than numbers. It involves complex human behaviors such as greed and deception, factors that are difficult to identify and quantify. In short, books, records, and computers don't commit fraud—people do.

Understanding why and how "ordinary" people engage in fraudulent behavior has been my life's work. Like many readers of this book, I began my professional career as an accountant. But after two years toiling in the ledgers of one of the large international accounting firms, I realized that auditing was not my calling. In search of adventure, I became a real-life, gun-toting FBI agent.

The truth is that I was more often armed with my Sharp model QS-2130 calculator than my trusty Smith & Wesson model 60 five-shot stainless-steel revolver. Sure, there were the occasional gun battles. But most of the time I was waging war against corporate titans and crooked politicians. In the decade I spent with the Federal Bureau of Investigation, I learned a difficult and humbling lesson: My accounting education and training had not adequately prepared me for fighting fraud. But the status of antifraud education since then has begun to change, little by little.

To assist today's accounting students, *Principles of Fraud Examination* is written to provide a broad understanding of fraud—what it is and how it is committed, prevented, detected, and resolved.

Understanding how fraud is committed is paramount to preventing and detecting it. I've learned that in the 30-plus years since I carried a badge and gun. After I left the FBI in the early 1980s, I offered fraud investigation services to major corporations. Then, in 1988, I became the chairman of the Association of Certified Fraud Examiners, the world's largest antifraud organization. It is a position I still hold. In that capacity, I write, educate, and research fraud issues.

This work has its genesis in my fifth book, *Occupational Fraud and Abuse*, first published in 1997. At the time, I was intrigued by the definition of *fraud* as classically set forth in *Black's Law Dictionary*:

> *All multifarious means which human ingenuity can devise, and which are resorted to by one individual to get an advantage over another by false suggestions or suppression of the truth. It includes all surprise, trick, cunning or dissembling, and any unfair way which another is cheated.*

The definition implied to me that there was an almost unlimited number of ways people could think up to cheat one another. But my experience told me something else: After investigating and researching thousands of frauds, they seemed to fall into definite patterns. If we could somehow determine what those patterns were and in what frequency they occurred, it would aid greatly in understanding and ultimately preventing fraud. And since so much fraud occurs in the workplace, this particular area would be the starting point.

So I began a research project with the aid of more than 2,000 Certified Fraud Examiners. They typically work for organizations in which they are responsible for aspects of fraud detection and deterrence. Each CFE provided details on exactly how their organizations were being victimized from within. That information was subsequently summarized in a document for public consumption, the *Report to the Nation on Occupational Fraud and Abuse*. The first Report was issued in 1996. Since then, it has been updated six times, the most recent being in 2012.

Rather than an unlimited number of schemes, the reports have concluded that occupational fraud and abuse can be divided into three main categories: asset misappropriation, corruption, and fraudulent statements. From the three main categories, several distinct schemes were identified and classified; they are covered in detail herein.

Principles of Fraud Examination begins by providing an understanding of fraud examination methodology. Thereafter, it sets forth the schemes used by executives, managers, and employees to commit fraud against their organizations. This 4th edition of the text also includes a chapter on frauds perpetrated against organizations by individuals outside their staff—a growing threat for many entities as commerce increasingly crosses technological and geographical borders.

Each chapter is organized similarly. The major schemes are illustrated and detailed. Statistics are provided and the schemes are flowcharted. Case studies are provided for each chapter. Prevention, detection, and investigation strategies are outlined. Finally, the chapters have essential terms, questions, and discussion issues to help you understand and retain the material you have learned.

Writing this book is not a solo venture, even though I accept responsibility for every word—right or wrong. I am deeply indebted to John Warren, JD, CFE. Without his assistance, this undertaking would have been a nearly impossible task. John is responsible for major areas, including the statistical information and analysis, writing, and editing. Special thanks are due to several key ACFE staffers who assisted me: John Gill, Andi McNeal, Catherine Lofland, Jeanette LeVie, Jim Ratley, and Jenny Carnahan.

For their assistance in helping prepare learning objectives, chapter summaries, essential terms, and discussion issues and questions, I am indebted to Linda Chase, Scarlett Farr, Kristy Holtfreter, Robert Holtfreter, Bonita Peterson, Zabiollah Rezaee, Nazik Roufaiel, and Matthew Samuelson. Mary-Jo Kranacher provided invaluable assistance in her work on Chapters 10, 11, 12, and 17.

Finally, I must thank my wife, Judy. Since I've authored 21 books, she has learned well that this endeavor is a solitary pursuit. Without her unconditional love, encouragement, and patience, these pages could not have been written.

Joseph T. Wells
Austin, Texas
March 2013

BRIEF CONTENTS

CONTENTS

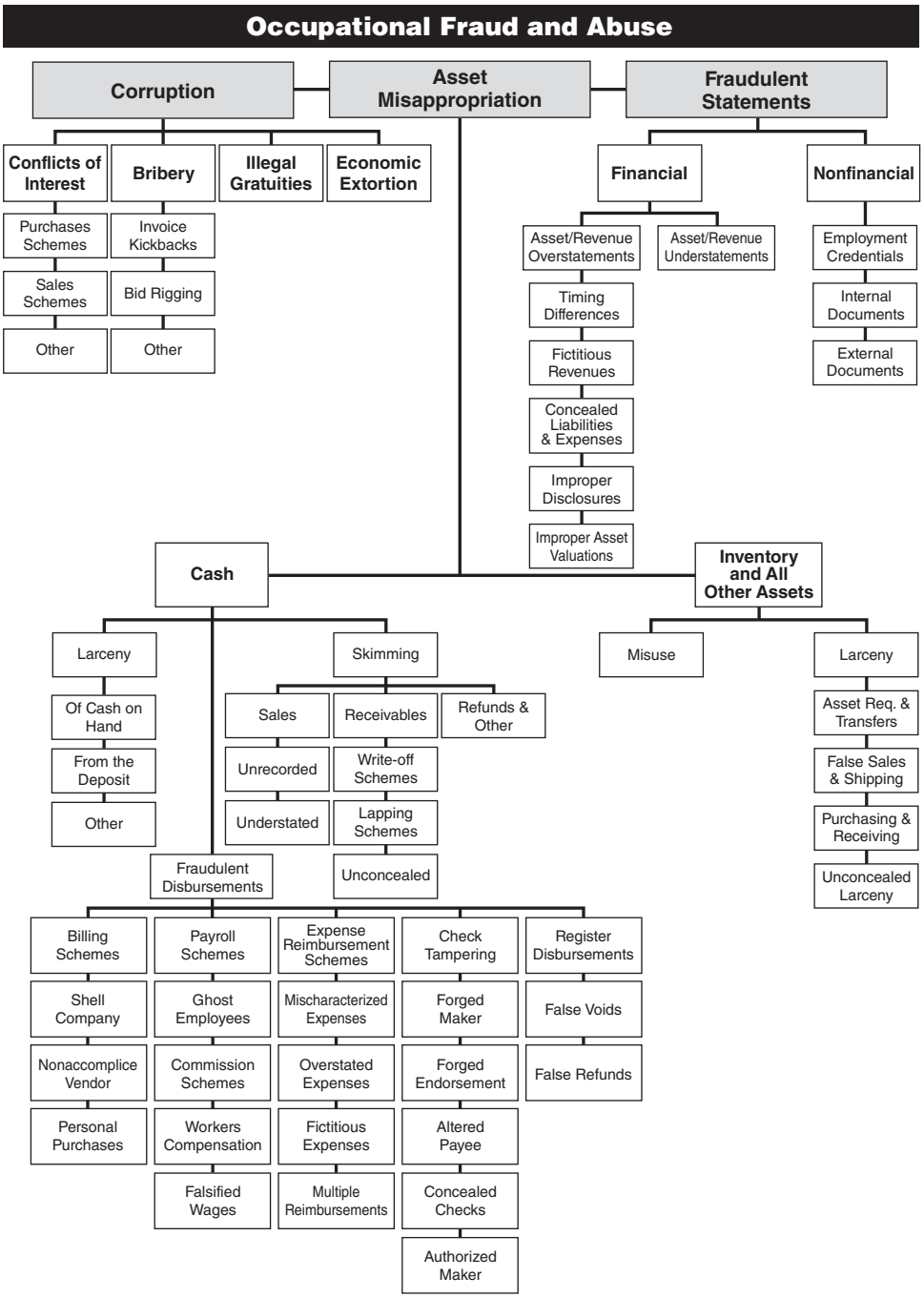
Occupational Fraud and Abuse
Corruption
Asset Misappropriation
Fraudulent Statements
Conflicts of Interest
Bribery
Illegal Gratuities
Economic Extortion
Purchases Schemes
Sales Schemes
Other
Invoice Kickbacks
Bid Rigging
Other
Financial
Nonfinancial
Asset/Revenue Overstatements
Asset/Revenue Understatements
Timing Differences
Fictitious Revenues
Concealed Liabilities & Expenses
Improper Disclosures
Improper Asset Valuations
Employment Credentials
Internal Documents
External Documents
Cash
Inventory and All Other Assets
Larceny
Of Cash on Hand
From the Deposit
Other
Skimming
Sales
Receivables
Refunds & Other
Unrecorded
Understated
Write-off Schemes
Lapping Schemes
Unconcealed
Misuse
Larceny
Asset Req. & Transfers
False Sales & Shipping
Purchasing & Receiving
Unconcealed Larceny
Fraudulent Disbursements
Billing Schemes
Shell Company
Nonaccomplice Vendor
Personal Purchases
Payroll Schemes
Ghost Employees
Commission Schemes
Workers Compensation
Falsified Wages
Expense Reimbursement Schemes
Mischaracterized Expenses
Overstated Expenses
Fictitious Expenses
Multiple Reimbursements
Check Tampering
Forged Maker
Forged Endorsement
Altered Payee
Concealed Checks
Authorized Maker
Register Disbursements
False Voids
False Refunds

EXHIBIT 1-1

CHAPTER 1

INTRODUCTION

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

1-1 Define fraud examination and differentiate it from auditing
1-2 Understand the fraud theory approach
1-3 Define occupational fraud
1-4 Define fraud
1-5 Define abuse
1-6 Know the difference between fraud and abuse
1-7 Describe the criminological contributions of Edwin H. Sutherland
1-8 Understand Donald Cressey's hypothesis
1-9 Give examples of nonshareable problems that contribute to fraud
1-10 Understand how perceived opportunity and rationalization contribute to fraud
1-11 Explain W. Steve Albrecht's "fraud scale"
1-12 Summarize the conclusions of the Hollinger-Clark study
1-13 Summarize the findings of the *2011 Global Fraud Survey*

Assume that you are an auditor for Bailey Books Corporation of St. Augustine, Florida. With $226 million in annual sales, Bailey Books is one of the country's leading producers of textbooks for the college and university market and of technical manuals for the medical and dental professions.

On January 28, you received a telephone call. The caller advised that he did not wish to disclose his identity. However, he claimed to have been a long-term supplier of paper products to Bailey Books. The caller said that since Linda Reed Collins took over as purchasing manager for Bailey Books several years ago, he was systematically squeezed out of doing business with the company. He hinted that he thought Collins was up to something illegal. You queried the caller for additional information, but he hung up. What do you do now?

This case is fictional, but the situation is a common one in the world of commerce. Organizations incur costs in order to produce and sell their products or services. And such costs run the gamut: labor, taxes, advertising, occupancy, raw materials, research and development—and yes, fraud and abuse. The last cost, however, is fundamentally different from the others—the true expense of fraud and abuse is hidden, even if it is reflected in the profit-and-loss figures. Sometimes these offenses can constitute multibillion-dollar accounting misstatements, but much more frequently, they involve asset misappropriations or corruption, such as the fraud alluded to by the caller in the example above.

Resolving allegations of fraud—whether from tips, complaints, or accounting clues—is the discipline of fraud examination. It involves obtaining documentary evidence, interviewing witnesses and potential suspects, writing investigative reports, testifying to findings, and assisting in the general detection and prevention of fraud. Fraud examination has similarities to the field of *forensic accounting*, but the two terms are not precisely equivalent. Forensic accounting is the use of any accounting knowledge or skill for courtroom purposes and can therefore involve not only fraud, but also bankruptcy, business valuations and disputes, divorce, and a host of other litigation support services. On the other hand, though fraud examinations are typically performed by accountants, they can also be conducted by professionals in other fields, such as law enforcement officials, corporate security specialists, or private investigators.

Similarly, fraud examination and auditing are related, but are not identical. Because most occupational frauds are financial crimes, a certain degree of auditing is necessarily involved. But a fraud examination encompasses much more than just the review of financial data; it also involves techniques such as interviews, statement analyses, public records searches, and forensic document examination. Furthermore, there are significant differences between the two disciplines in terms of their scopes, objectives, and underlying presumptions. The following table summarizes the differences between the two disciplines.

Auditing vs. Fraud Examination

Issue	Auditing	Fraud Examination
Timing	**Recurring** Audits are conducted on a regular, recurring basis.	**Nonrecurring** Fraud examinations are nonrecurring. They are conducted only with sufficient predication.
Scope	**General** The audit is a general examination of financial data.	**Specific** Fraud examinations are conducted to resolve specific allegations.
Objective	**Opinion** An audit is generally conducted to express an opinion on financial statements or related information.	**Affix blame** The fraud examination determines whether fraud has occurred, and if so, who is responsible.
Relationship	**Nonadversarial** The audit process does not seek to affix blame.	**Adversarial** Fraud examinations involve efforts to affix blame.
Methodology	**Audit techniques** Audits are conducted primarily by examining financial data.	**Fraud examination techniques** Fraud examinations are conducted by (1) document examination, (2) review of outside data such as public records, and (3) interviews.
Presumption	**Professional skepticism** Auditors are required to approach audits with professional skepticism.	**Proof** Fraud examiners approach the resolution of a fraud by attempting to establish sufficient proof to support or refute an allegation of fraud.

FRAUD EXAMINATION METHODOLOGY

Fraud examination methodology requires that all fraud allegations be handled in a uniform, legal fashion, and that they be resolved in a timely manner. Assuming there is sufficient reason (predication) to conduct a fraud examination, specific steps are employed in a logical progression that is designed to narrow the focus of the inquiry from the general to the specific, eventually centering on a final conclusion. The fraud examiner begins by developing a hypothesis to explain how the alleged fraud was committed, and by whom. As each step of the fraud examination process uncovers more evidence, that hypothesis is amended and refined.

Predication

Predication is the totality of circumstances that would lead a reasonable, professionally trained, prudent individual to believe that a fraud has occurred, is occurring, or will occur. All fraud examinations must be based on proper predication; without it, a fraud examination should not be commenced. An anonymous tip or complaint, as in the Linda Reed Collins example cited earlier, is a common method for uncovering fraud; such a tip is generally considered sufficient predication. However, mere suspicion, without any underlying circumstantial evidence, is not a sufficient basis for conducting a fraud examination.

Fraud Theory Approach

In most occupational fraud cases, it is unlikely that there will be direct evidence of the crime. There are rarely eyewitnesses to a fraud, and it is unlikely—at least at the outset of an investigation—that the perpetrator will come right out and confess. Thus a successful fraud examination takes various sources of incomplete circumstantial evidence and assembles them into a solid, coherent structure that either proves or disproves the existence of the fraud.

To solve a fraud without complete evidence, the fraud examiner must make certain assumptions, not unlike a scientist who postulates a theory based on observation and then tests it. When investigating complex frauds, the fraud theory approach is almost indispensable. Fraud theory begins with an assumption, based on the known facts, of what might have occurred. That assumption is then tested to determine whether it can be proven. The fraud theory approach involves the following sequence of steps:

1. Analyze available data
2. Create a hypothesis
3. Test the hypothesis
4. Refine and amend the hypothesis

Let us illustrate using the Linda Reed Collins scenario. When you received the telephone call from a person purporting to be a vendor, you had no idea whether the information was legitimate. There could have been many reasons why a vendor would feel unfairly treated. Perhaps he just lost Bailey's business because another supplier provided inventory at a lower cost. Under the fraud theory approach, you must analyze the available data before developing a preliminary hypothesis about what may have occurred.

Analyzing Available Data If an audit of the entire purchasing function was deemed appropriate, it would be conducted at this time and would specifically focus on the possibility of fraud resulting from the anonymous allegation. For example, a fraud examiner would look at how contracts are awarded and at the distribution of contracts among Bailey Books' suppliers.

Creating a Hypothesis Based on the caller's accusations, you would develop a hypothesis to focus your efforts. The hypothesis is invariably a "worst-case" scenario. That is, with the limited information you possess, what is the worst possible outcome? In this case, for Bailey Books, it would probably be that its purchasing manager was accepting kickbacks to steer business to a particular vendor. A hypothesis can be created for any specific allegation, such as a bribery or kickback scheme, embezzlement, a conflict of interest, or financial statement fraud.

Testing the Hypothesis After the hypothesis has been developed, it must be tested. This involves developing a "what-if" scenario and gathering evidence to either prove or disprove the proposition. For example, if a purchasing manager like Linda Reed Collins were being bribed, a fraud examiner likely would find some or all of the following:

- A personal relationship between Collins and a vendor
- Ability of Collins to steer business toward a favored vendor
- Higher prices or lower quality for the product or service being purchased
- Excessive personal spending by Collins

In the hypothetical case of Linda Reed Collins, you—using Bailey Books' own records—can readily establish whether one vendor is receiving a proportionally larger share of the business than other vendors. You can ascertain whether Bailey Books was paying too much for a particular product, such as paper, simply by calling other vendors and determining competitive pricing. Furthermore, purchasing managers don't usually accept offers of kickbacks from total strangers; a personal relationship between a suspected vendor and the buyer could be confirmed by discreet observation or inquiry. And whether Collins has the ability to steer business toward a favored vendor could be determined by reviewing the company's internal controls to ascertain who is involved in the decision-making process. Finally, the proceeds of illegal income are not normally hoarded; such money is typically spent. Collins's lifestyle and spending habits could be determined through examination of public documents such as real estate records and automobile liens.

Refining and Amending the Hypothesis In testing the hypothesis, a fraud examiner might find that the facts do not fit a particular scenario. If this is the case, the hypothesis should be revised and retested. Gradually, as the process is repeated and the hypothesis is continually revised, the examiner works toward the most likely and supportable conclusion. The goal is not to "pin" the crime on a particular individual, but rather to determine, through the methodical process of testing and revision, whether a crime has been committed—and if so, how.

Tools Used in Fraud Examinations

Three tools are available regardless of the nature of a fraud examination. First, the fraud examiner must be skilled in the examination of financial statements, books and records, and supporting documents. In many cases, these will provide the indicia of fraud upon which a complete investigation is based. The fraud examiner must also know the legal ramifications of evidence and how to maintain the chain of custody over documents. For example, if it is determined that Linda Reed Collins was taking payoffs from a supplier, checks and other financial records to prove the case must be lawfully obtained and analyzed, and legally supportable conclusions must be drawn.

The second tool used by fraud examiners is the interview, which is the process of obtaining relevant information about the matter from those who have knowledge of it.

EXHIBIT 1-2 Evidence-Gathering Order in Fraud Examinations

For example, in developing information about Linda Reed Collins, it might be necessary to interview her coworkers, superiors, and subordinates.

In a fraud examination, evidence is usually gathered in a manner that moves from the general to the specific (see Exhibit 1-2). That rule applies both to gathering documentary evidence and taking witness statements. Thus, a fraud examiner would most likely start by interviewing neutral third-party witnesses, persons who may have some knowledge about the fraud but who are not involved in the offense. Next, the fraud examiner would interview corroborative witnesses—those people who are not directly involved in the offense, but who may be able to corroborate specific facts related to the offense.

If, after interviewing neutral third-party witnesses and corroborative witnesses, it appears that further investigation is warranted, the fraud examiner proceeds by interviewing suspected co-conspirators in the alleged offense. These people are generally interviewed in a particular order, starting with those thought to be least culpable and proceeding to those thought to be most culpable. Only after suspected co-conspirators have been interviewed is the person who is suspected of committing the fraud confronted. By arranging interviews in order of probable culpability, the fraud examiner is in a position to have as much information as possible by the time the prime suspect is interviewed. The methodology for conducting interviews will be discussed in Chapter 16.

The third tool that must be used in a fraud examination is observation. Fraud examiners are often placed in a position in which they must observe behavior, search for displays of wealth, and, in some instances, observe specific offenses. For example, a fraud examiner might recommend a video surveillance if it is discovered that Linda Reed Collins has a meeting scheduled with a person suspected of making payoffs.

Fraud examination methodology can be applied to virtually any type of fraud investigation. Although suspected frauds can be categorized by a number of different methods, they are usually referred to as "internal frauds" or "external frauds." The latter refers to offenses committed by individuals against other individuals (e.g., con schemes), by individuals against organizations (e.g., insurance fraud), or by organizations against individuals (e.g., consumer frauds), but the former refers to offenses committed by the

people who work for organizations; these are the most costly and the most common frauds. A more descriptive term for these crimes, as we shall see, is *occupational fraud and abuse*. This book will concentrate exclusively on occupational fraud and abuse: how it is committed, how it is prevented, and how it is investigated.

DEFINING OCCUPATIONAL FRAUD AND ABUSE

For purposes of this book, *occupational fraud and abuse* is defined as

> *The use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources or assets.*[1]

This definition's breadth means that occupational fraud and abuse involves a wide variety of conduct by executives, employees, managers, and principals of organizations, ranging from sophisticated investment swindles to petty theft. Common violations include asset misappropriation, fraudulent statements, corruption, pilferage and petty theft, false overtime, use of company property for personal benefit, and payroll and sick time abuses. Four elements common to these schemes were first identified by the Association of Certified Fraud Examiners in its *1996 Report to the Nation on Occupational Fraud and Abuse*, which stated: "The key is that the activity (1) is clandestine, (2) violates the employee's fiduciary duties to the organization, (3) is committed for the purpose of direct or indirect financial benefit to the employee, and (4) costs the employing organization assets, revenues, or reserves."[2]

An "employee," in the context of this definition, is any person who receives regular and periodic compensation from an organization for his labor. The employee moniker is not restricted to the rank-and-file, but specifically includes corporate executives, company presidents, top and middle managers, and other workers.

Defining Fraud

In the broadest sense, fraud can encompass any crime for gain that uses deception as its principal modus operandi. Of the three ways to illegally relieve a victim of money—force, trickery, or larceny—all offenses that employ trickery are frauds. Since deception is the linchpin of fraud, we will include *Merriam-Webster's* synonyms: "'Deceive' implies imposing a false idea or belief that causes ignorance, bewilderment, or helplessness; 'mislead' implies a leading astray that may or may not be intentional; 'delude' implies deceiving so thoroughly as to obscure the truth; 'beguile' stresses the use of charm and persuasion in deceiving."[3]

Although all frauds involve some form of deception, not all deceptions are necessarily frauds. Under common law, four general elements must be present for a fraud to exist:

1. A material false statement
2. Knowledge that the statement was false when it was uttered
3. Reliance of the victim on the false statement
4. Damages resulting from the victim's reliance on the false statement

The legal definition of fraud is the same whether the offense is criminal or civil; the difference is that criminal cases must meet a higher burden of proof.

Let's assume an employee who worked in the warehouse of a computer manufacturer stole valuable computer chips while no one was looking and resold them to a competitor.

This conduct is certainly illegal, but what law has the employee broken? Has he committed fraud? The answer, of course, is that it depends. Let us briefly review the legal ramifications of the theft.

The legal term for stealing is *larceny*, which is defined as "felonious stealing, taking and carrying, leading, riding, or driving away with another's personal property, with the intent to convert it or to deprive the owner thereof."[4] In order to prove that a person has committed larceny, we would need to prove the following four elements: (1) There was a taking or carrying away (2) of the money or property of another (3) without the consent of the owner and (4) with the intent to deprive the owner of its use or possession. In our example, the employee definitely "carried away" his employer's property, and we can safely assume that this was done without the employer's consent. Furthermore, by taking the computer chips from the warehouse and selling them to a third party, the employee clearly demonstrated intent to deprive his employer of the ability to possess and use those chips. Therefore, the employee has committed larceny.

The employee might also be accused of having committed a tort known as *conversion*.[5] Conversion, in the legal sense, is "an unauthorized assumption and exercise of the right of ownership over goods or personal chattels belonging to another, to the alteration of their condition or the exclusion of the owner's rights."[6] A person commits a conversion when he takes possession of property that does not belong to him and thereby deprives the true owner of the property for any length of time. The employee in our example took possession of the computer chips when he stole them, and by selling them he has deprived his employer of that property. Therefore, the employee has also engaged in conversion of the company's property.

Furthermore, the act of stealing the computer chips also makes the employee an embezzler. According to *Black's Law Dictionary*, to *embezzle* means "willfully to take, or convert to one's own use, another's money or property of which the wrongdoer acquired possession lawfully, by reason of some office or employment or position of trust."[7] The key words in that definition are "acquired possession lawfully." In order for an embezzlement to occur, the person who stole the property must have been entitled to possession of the property at the time of the theft. Remember, "possession" is not the same thing as "ownership." In our example, the employee might be entitled to possess the company's computer chips (to assemble them, pack them, store them, etc.), but clearly the chips belong to the employer, not the employee. When the employee steals the chips, he has committed embezzlement.

We might also observe that some employees have a recognized fiduciary relationship with their employers under the law. The term *fiduciary*, according to *Black's Law Dictionary*, is of Roman origin and means:

> *a person holding a character analogous to a trustee, in respect to the trust and confidence involved in it and the scrupulous good faith and candor which it requires. A person is said to act in a "fiduciary capacity" when the business which he transacts, or the money or property which he handles, is not for his own benefit, but for another person, as to whom he stands in a relation implying and necessitating great confidence and trust on the one part and a high degree of good faith on the other part.*[8]

In short, a fiduciary is someone who acts for the benefit of another.

A fiduciary has a duty to act in the best interests of the person whom he represents. When he violates this duty he can be liable under the tort of *breach of fiduciary duty*. The elements of this cause of action vary among jurisdictions, but in general they consist of the following: (1) a fiduciary relationship between the plaintiff and the defendant, (2) breach of the defendant's (fiduciary's) duty to the plaintiff, and (3) harm to the plaintiff or