

A Small Town Texas Fraud

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In 2014 a former corporate controller was convicted of stealing over \$16 million from a small town, family owned, Texas bakery which conducted most of its business online. His wife was also convicted, having knowingly participated in spending the money to support the couples' extremely lavish lifestyle. This trusted employee, after almost seven years employment, started stealing. The fraud continued undetected and unsuspected for eight and one half years. This paper looks at how it was carried out, the lifestyle it allowed, how it was eventually discovered, and finally why it should have been easily detected soon after it started.

The Collin Street Bakery is a Texas icon. Purchased from the original founders, this family owned and managed business, is now into its fourth generation. Since its founding in 1896 it has operated a retail store, and later a plant, in Corsicana, Texas. Almost all of its revenue comes from the sale of its Deluxe Fruitcakes. Initially all sales were from its local store but since 1947 it has developed a very large mail order business which now accounts for the majority of its sales. In recent years it has opened a few new brick and mortar stores in an effort to be less reliant on the mail order – now online – business. They ship to all 50 states and 196 foreign countries, selling 1.5 million cakes per year – 3 million pounds of product. Although they are a private company, not required to disclose their financial performance, based on the price of their products, it is likely they have sales revenues in excess of \$50 million annually.

Sandy Jenkins was a Texas trained accountant with prior accounting work experience. In 1998, aged 49, he was diagnosed with manic depression and prescribed medication. That same year he was hired by the bakery as a payroll and accounts payable supervisor, making \$25,000 a year. His job performance was good. He also proved himself by helping the bakery transition from a manual accounting system to a computerized one. In 2000 he was promoted to corporate controller, with Scott Hollomon as his supervisor. By 2004 Sandy had worked at the bakery for six years and was making \$50,000 a year. He had proved himself a reliable employee.

It's impossible to know what someone is thinking, but looking back, fellow employees expressed a number of things which they thought triggered his upcoming behavior: a feeling that he was not paid enough, resentment towards the CEO who enjoyed a very high standard of living and whom he saw as being very entitled, a personal desire to enjoy the good things in life, and his mental health issues. In December 2004, his need for money finally led him to steal money from the bakery's petty cash fund. No one noticed and so he continued this behavior. A few weeks later he bought a used Lexus, trading in his older Lexus as a down payment. However, he could not afford the payments on the new vehicle. On January 25 2005, when his credit card payment was due, he started his check fraud scheme. This involved

the use of voided checks. Knowing that no one paid attention to the voided check file, he felt fairly safe, with little chance of detection.

He issued a \$20,000 check payable to CitiCard, his personal credit card issuer. The software automatically signed the check "Bob McNutt" - the CEO. He printed the check, then voided it in the company system, but still mailed it, thereby converting company funds to personal use. To cover his tracks, he typed the next check payable to a legitimate bakery vendor for the same amount but never mailed it. The net result was the first check paid his personal credit card bill but it was the second check which was recorded in the bakery financial records as a payment to a vendor for an operating expense. The effect of this was that company expenses were inflated in the company records, because in addition to such checks, legitimate invoices from the vendors were also paid.

Once he was sure that nobody noticed the first fraudulent check transaction, he repeatedly stole money in this way, writing 888 fraudulent checks in total by the time the fraud was detected. The result of his scheme was that for each of the 888 fraudulent checks, in the company records, the recorded nonexistent payment was made by a check numbered one digit higher than the fraudulent check which was the one presented to, and paid by, the company's bank. He timed the checks well. He knew when the bakery would stock up on ingredients and when it would be spending more on postage, and he would pad these expense areas that would normally be high so that when the bakery ran a financial or marketing analysis, nothing seemed too unusual.

In total Jenkins stole at least \$114,342 from the petty cash fund, and the 888 forged checks totaled \$16,649,786.91. This worked out to an average of just under \$2 million a year over the eight and one half years the fraud continued. Jenkins's spending was lavish and extremely extravagant and totally divorced from what was possible for someone on a salary of under \$100,000 a year. He and his wife Kay took 223 trips on private jets, primarily to Santa Fe New Mexico, Aspen Colorado, and Napa California, with a total cost in excess of \$3.3 million. This averaged out to one trip every two weeks. They purchased a total of 38 vehicles, including many Lexus automobiles, a Mercedes Benz, a Bentley, and a Porsche. According to evidence presented at sentencing, Sandy and Kay Jenkins purchased a new automobile every time they needed an oil change. In an effort to minimize suspicion, they often purchased the same model of Lexus, in exactly the same color, so that it was not obvious that it was a new vehicle.

The couple spent over \$11 million on a Black American Express card - roughly \$98,000 per month. Approximately \$1.2 million was spent at Neiman Marcus at Northpark Mall in Dallas, approximately one hour north of Corsicana. There, the sales staff had given Sandy and Kay nicknames; "Fruitcake" and "Cupcake," respectively. Evidence at sentencing stated that the Jenkins stopped shopping at Neiman Marcus simply because Neiman's ran out of different things to sell them.

The bakery owners had wondered, year after year, why the bakery wasn't making more money. The company had recently opened a number of brick and mortar locations and they wondered if the company was expanding too quickly. Some years they blamed the economy but in other years they had no feasible explanation. In their search for answers they audited the payroll, examined their labor costs, the price of ingredients, and the inventory of ingredients. They also considered mismanagement but no answer was found. Their search for an explanation and their suspicions fell on everything except their own employees because company management had complete confidence in the honesty of their staff, operating as they did in the cordial environment of a family operated business.

Once, the fraud was almost detected. The director of e-commerce and call services, Darlene Johnston, typically spent a small amount of money promoting one of the bakery's side businesses, a small mail-order company called Cryer Creek Kitchens. These expenses had increased exponentially and she was told by Scott Hollomon to not spend any more on Cryer Creek Kitchens. Johnston looked at the numbers and denied spending \$23,000 on postage, stating, "that's crazy." But the paperwork showed that she had. Sandy offered to look into it and reported back that everything seemed to be in order, and the issue was dropped.

The fraud was finally discovered on June 20, 2013 when an accounting clerk named Semetric Williams, a relatively new hire who had been with the company for less than a year, discovered a \$20,000 check written for a \$10,000 postal bill. When she asked Sandy about it he replied that he would fix it.

This discrepancy made her suspicious and so while Sandy was out of the office that afternoon looking for a new house, she started to investigate. Upon looking through the voided check register, she quickly found eleven discrepancies worth approximately \$400,000. She immediately notified her superiors and the fraud was now uncovered. When he arrived at work the next day, Sandy was confronted with the evidence and terminated. Law enforcement authorities were brought in and both Sandy and Kay Jenkins were criminally charged.

In total approximately \$4,000,000 in property and cash was recovered and turned over to the bakery as partial restitution for their losses suffered. After taking into consideration the amount turned over to the company, the Court ordered restitution to be paid to the bakery, jointly and severally by Sandy and Kay Jenkins in the amount of \$12,697,921.79. Sandy Jenkins, now aged 65, pleaded guilty in May 2014 to one count of mail fraud, one count of conspiracy to commit money laundering, and one count of making a false statement to a financial institution. Kay Jenkins, aged 64, pleaded guilty in May 2015 to one count of conspiracy to commit money laundering. Sandy Jenkins was sentenced by U.S. District Judge Ed Kinkeade to serve a total of 120 months in federal prison. Judge Kinkeade sentenced Kay Jenkins to five years' probation. Kay Jenkins was further ordered to complete 100 hours of community service and to submit a formal apology in writing to the Bakery.

This fraud could have easily been prevented and failing that it should have been detected soon after it began. Perhaps the biggest mistake the company made was that there were no effective checks on the work of the accounting staff. History has shown, over and over and over again, that regardless of the reputation and abilities of employees, fraud often occurs and therefore the work of all employees, no matter the position they hold, should, at least from time to time, be reviewed. Ironically, it is often one of the most trusted employees of a company who engages in fraudulent activity.

As a private company the bakery was not required to be independently audited. However, for a company this size, consulting with an independent CPA firm, at least on some matters, would be a prudent use of funds. A perfect example of this would be seeking advice on their system of internal controls. Once management became concerned about the lower than expected profits, an independent review of the company accounts likely would have very quickly found the fraudulent activity because of the huge red flag present – the 888 “missing” check numbers which had never been presented to the bank along with the 888 check numbers recorded in the system which did not match those on the bank statements.

Basic internal controls were not in place. One person should never, in a business this size, have total control over the processing of invoices, the issuing of checks and then account reconciliations. Valid receipts were missing for the money spent from the petty cash fund. While the amount spent from this source was tiny compared to the check fraud, an amount of more than \$100,000 is a huge amount to be spent from petty cash. This amount, when compared to prior petty cash spending, should have raised suspicion. A study of the bank statements would have revealed that many checks were never presented. The large numbers of these, even early on, should have raised suspicions.

The company looked at spending on such things as inventory, labor and postage and did not detect a problem. However, the ratios must have been off compared to past results, because the more than \$16 million of fraudulent checks were recorded as being spent on these items, in addition to the valid expenditures on these items. Unless there were compensating savings on these valid expenditures, due to improved efficiencies in production, an analysis should have shown that spending on these items combined was up by approximately \$2 million per year. With respect to fruitcake ingredients, this is really not possible, especially for a premium high cost product as was the case here. Once any price changes in ingredients had been accounted for, the only way to spend less on ingredients is to use fewer of them and this would immediately impact product quality and be noticed by both the quality control staff and customers.

When Darlene Johnston stated that she had not spent \$23,000 on postage for Cryer Creek Kitchens, this issue should have been looked into further rather than just accepting Sandy's assurance that it was valid. She would be expected to know if she had spent such a relatively large amount on postage for a

small sideline business. Full and complete verification should have been sought, and in doing so, the fraud would have been detected.

One method of detecting fraud used by some foreign governments is a lifestyle check of the employee. If the assets owned and the lifestyle enjoyed by the employee are far in excess of what is possible based on their income, this is a sign that fraud may have taken place. Such a method cannot be used by a private business in the U.S. However, observations of the employee can provide such clues. Much of the spending engaged in by the Jenkins was obvious to those around them, in the form of jewelry, clothing, vehicles, vacations, and housing. When management was searching for answers, it could have put two and two and two together and at least considered the possibility that Sandy Jenkins was stealing from the company. After all, at a time when profits and cash were lower than expected, the person controlling the check book suddenly began living a very lavish lifestyle, totally unaffordable by someone on his salary.

This fraud was made possible and prolonged by the fact that it hit the “sweet spot” in terms of company cash flow. Sufficient funds were available in the business over the eight and one half year period so that Jenkins was able to steal over \$16 million and still not put the business in a position where it could not continue to operate. However, as outlined above, it should not have been possible in the first place, but if commenced, it should have been quickly detected.

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