Subcommittee on Oversight and Investigations
Committee on Education and the Workforce
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The Financial Affairs of the International Brotherhood of Teamsters

Mr. Chairman, distinguished members of this House Subcommittee, and guests at this hearing, thank you for this opportunity.

I. *Introduction*

To discuss the financial affairs of the International Brotherhood of Teamsters I must cover not only the Union's finances but also three key areas: "accountability," "reporting" and "oversight" and whether the organization was effective or ineffective in each of those areas.

The Teamsters' union is in crisis. It is both a financial and managerial crisis. Financial crisis because the Teamster's most recent internal accounting statements show it is nearly insolvent. Its net worth, which was more than $156 million on January 1, 1992, dropped to a mere $700,000 on September 30, 1997.

Managerial crisis because the General President was reelected in 1996 under a government supervised election at a cost to the taxpayers of approximately $20 million. Ron Carey is now removed amid allegations of fraud and the misuse of treasury funds related to his reelection. This has brought the Union into a leadership crisis, requiring a new election.

1. <u>Questions</u>

Between 1992 and 1997, the Teamsters' net worth declined by an average of $26 million per year, an estimated $100,000 every working day. This is more than rank-and-file workers receive in a year. Think of it as a loss of $12,500 for every working hour.

This horrendous loss begs answers for three questions:

- Where did all the money go?

- Where was the oversight by the Department of Justice, the Independent Review Board and the regulators at the Department of Labor? and,

- Are current Teamster officials covering up a systemic and wide ranging series of fraudulent and illegal financial activities?

2. <u>Personal information</u>

I am Frederick W. Smolen, Chief Forensic Auditor of the Subcommittee. I'm a Certified Public Accountant and serve the business, financial and legal community as an advisor, consultant and expert witness. Based on my profession's standards, in addition to what has been already learned, there appears to be fraudulent financial activities at the Teamsters between 1992 and 1997. This conclusion is because of: (1) domination, without controls. of Teamster management by a small group of individuals, (2) missing documents, (3) refusal by the IBT to provide information including financial books and records, and (4) financial analyses reflecting unexpected and significant differences.

For the last twenty years I've investigated business and financial affairs of numerous publicly held and privately held entities including not-for-profit organizations. Many were involved in fraudulent financial activities, faced bankruptcy or went bankrupt. Since my hiring six weeks ago, I've worked to ensure that you Mr. Chairman, and the members of this Subcommittee, are presented with relevant information relating to the finances of the Teamsters, and especially those in 1996.

However, our staff has been obstructed in its efforts to provide a comprehensive financial picture to this Subcommittee. Documents that would provide information on what has happened to the money are not being produced. And, the information that is being produced includes missing documents and conflicting data. To illustrate this point, in 1994 the Teamster's Affiliates Pension Plan was terminated. The produced documents included the 'audited' 1994 financial statements. Missing from these financial statements was the page relevant to the terminated Pension Plan.

[EXHIBIT 7:Annual report/missing page]

By another example, the staff was informed by a Teamster employee that internal operating, finance and administrative manuals exist. The IBT subpoena, approved by this Subcommittee, was specifically drafted to include such language. The written response was "as the IBT has already informed the Subcommittee, there are no such manuals." This does not seem credible in an organization with 1,400,000 members and a payroll in excess of $25 million a year. In fact, a 1997 memo evidences the existence of such manuals.

By yet another example, Grant Thornton, IBT's independent auditors, initially agreed to a review of their audit working papers which would have provided information significant to this

Subcommittee. IBT attorneys instructed Grant Thornton not to produce the materials even though these audit working papers are the property of the CPAs.

So, my study of the IBT finances is limited by the lack of cooperation of the present IBT hierarchy. But what I can determine from the available documents and information is a history of:

- inadequate internal controls,
- absence of appropriate reviews and approvals,
- inadequate provisions for safeguarding assets,
- failure to safeguard assets from misappropriation and fraud,
- willful wrongdoing by senior officials,
- manipulation and falsification of accounting records,
- lack of management integrity, and
- refusal by senior officials to provide relevant records and information to those with delegated authority and responsibility, the Teamsters Trustees.

II. *IBT's Financial Affairs*

1. Background

The story of the International Brotherhood of Teamsters reflects the history of the labor movement. The story dates back to 1903 when representatives of independent local unions formed a labor organization that pooled the resources of individual locals. Through this organization, a foundation was laid for the largest trade union in North America, which now has approximately 1.4 million members and cuts across a variety of trades and industries including:

airlines, freight, motion pictures, dairy, construction, trucking and port facilities.

The recent history of the Teamsters is marked by the 1989 Consent Decree resulting from the Department of Justice bringing a Civil RICO action. This Consent Decree related to charges stemming, in part, from the misuse of Teamster treasury assets. As a consequence of this Consent Decree, in 1992 new management and a new Constitution were put into place. Notwithstanding these events, the financial affairs of the Teamsters have continued to catapult downhill until they reached where they are today -- an organization nearly insolvent.

2. Financial Affairs

Overview:

Between January 1, 1992 and September 30, 1997 the net worth of the Teamster's Union has virtually been wiped out. The financial reports that I examined show that in less than six years the Teamsters net worth lost over $155 million.

[EXHIBIT 8: IBT Chart 01 Net worth decrease]

This plunge in the net worth has been marked by an approximate $100 million decrease in assets from $179 million to $79 million, and an increase of $55 million in liabilities from $23 million to $78 million.

[EXHIBIT 9:IBT Chart 01(A) Asset/liability/worth]

1996 Financial Affairs:

Yet, that is only part of the story of the financial affairs. For during these years approximately half-a-billion dollars in revenues and loans were received by the Union's treasury. So, for all practical purposes, IBT's financial affairs deal with the accountability, reporting and oversight of more than $650 million, monies parsed among three Teamster funds -- a "General Fund," a "Special Organizing Fund" and a "Defense Fund."

Initially, concerns about the 1996 financial affairs dealt with matters related to the funding of Ron Carey's reelection campaign. In part, this was because a Teamsters' consultant pled guilty to a scheme involving a number of questionable financial practices used to fund Carey's reelection campaign -- funds were obtained under false pretenses from the union's treasury and passed through conduits to finance his campaign. Such transactions are considered "irregularities" and "illegal acts." The amount of funds identified with these activities is more than $700,000.

Yet, these were not the only 1996 transactions that added to the deteriorating financial condition of the Union. There is evidence of other questionable transactions because of unexpected and significant differences in the historical financial information. Even though IBT's financial downward slide continued, in 1996 there were significant dollar increases in non-officer wages and travel, certain professional fees and civic betterment. When compared to the prior year, some categories of expenses went up hundreds of percent. In absolute terms, these categories alone went up by more than $13 million when compared to the prior year.

[EXHIBIT 10:IBT Chart 02 - Non-officer wages/travel]
[EXHIBIT 11: IBT Chart 03 - Legal Fees, services, other]
[EXHIBIT 12: IBT Chart 04 - 'Civic Betterment']

This $13 million in added 1996 expenses resulted in 1996 general fund expenses exceeding the revenues. In other words, the Union was losing money even as approximately $17 million per year was coming in from a previously imposed rank-and-file special assessment.

[EXHIBIT 13:IBT Chart 05 - Excess (deficiency) General Fund]

Pension:

Contributing to this financial decline as well as obfuscating the picture were the pension costs. One pension plan was changed to make it more favorable to headquarters personnel by reducing the vesting period from five years to three years. As the plan covered only headquarters personnel, in substance it was a self-dealing transaction the costs of which were charged to the union treasury but borne by the rank-and-file workers.

Another pension plan, the Teamsters Affiliates Pension Plan, obfuscated the amount of the loss by reporting a $2.6 multimillion credit in 1996. This "credit" came from the same Pension Plan that had been terminated in 1994 and yet it had a continuing liability of approximately $28 million in 1996 appearing on the balance sheet. The liability, which ranged between $27 and $31 million since 1993, has appeared in the financial statements every year since 1993 even though the plan is fully funded. Despite requests for financial information, the staff has received no significant and substantive documentation or information from the Teamster's related to these Pension Plans.

[EXHIBIT 14:IBT Chart 06 - Affiliates Pension Costs/Liability]

IBT's $28 million Affiliates Pension Plan liability is significant not only because the Teamsters Affiliates Pension Plan is a separate and distinct financial entity but also because IBT never paid this Pension Plan the monies due. The Pension Plan Trustees were IBT officers and included Ron Carey, then IBT's General President, and Tom Sever, IBT's General Secretary-Treasurer.

For financial reporting, something was out of place because no funds were being paid to the Affiliates Pension Plan by the IBT. It's a liability with more form than substance. In 1994, Carey was told by the consulting actuaries that in a terminated plan, which the Pension Plan would soon be, any excess assets should be allocated back to the individual Affiliates, the Teamster locals and the rank-and-file workers. At Teamster headquarters, the economic motivation was to keep funds out of a pension plan that existed for the benefit of the rank-and-file workers. Absent adequate documentation, there can be no assurance that similar self-dealing transactions involving Teamster assets are not taking place.

Independent Review Board:

And, then there are the 1996 costs of $5.2 million relating to the Independent Review Board or the IRB. These costs as well as some of the underpinnings that brought about the financial and managerial crises can be traced back to the June 1991 Teamsters Convention and the adoption of a new Constitution.

III. The 1991 Teamsters Convention.

The International Brotherhood of Teamsters Convention took place in June 1991 where the delegates voted to adopt a new Constitution. Subsequent to the Convention, Ron Carey was elected General President.

1. The Constitution:

A new Constitution was adopted by the Teamster delegates in 1991. Subsequently, the U. S. Government required this 1991 Constitution be amended to include provisions the government believed were called for by the Consent Decree but had been voted down by the membership.

Directly or indirectly, three Articles of the Constitution bear on the present Teamsters financial crisis: (1) Article XIX dealing with Trials and Appeals and establishing the Independent Review Board, (2) Article VI dealing with the Duties and Powers of the General President, and (3) Article VIII dealing with the Duties of the Trustees.

2. The Independent Review Board

One of the Constitutional Amendments required by the government established the Independent Review Board, or IRB, a three-member quasi-government organization tasked, in part, to: (1) hear any union case referrals, and (2) investigate **any allegations of corruption** including embezzlement, bribery, use of threats of force or violence against members to interfere with their union rights, and other similar misconduct. Since 1991, the IRB and its related expenditures have cost the Teamster's treasury more than $40 million.

[EXHIBIT 15: IBT Chart 07 - RICO Costs]

Although the 1991 Convention delegates adopted an **Ethical Practices Committee** to consider "any allegation of corruption made by a member against any officer, member or Union entity," the U. S. Government did not approve of it. Rather, the U. S. Government required the Constitution be amended to include the IRB.

The result of this action was that:

1. The U. S. Government substantively took from the union a self-regulatory initiative, and

2. Union members began to look to the IRB for oversight and guidance relating to the efficacy of various policies and practices.

3. The General President

The 1991 International Convention also adopted Article VI covering the **Duties and Powers** of the **General President**. Among the President's powers were judicial powers giving him the authority to interpret the Constitution and laws of the International Union. Section 9 gives the General President "authority to make expenditures from the general fund in amounts to be determined by him in his sole discretion for lobbying and other political purposes including contributions."

[EXHIBIT 16:IBT Blowup/Chart 08 - Article VI.9]

16 B Article 8 Trustees

Additionally, the General President has the right to appoint one member to the three person IRB, subject to General Executive Board approval. In fact, the General President is given the power to place his personal representative on the Board.

4. The Trustees

Article VIII of the Constitution deals with the audit duties of the International Trustees. The International Trustees are required to review the books of the General Secretary-Treasurer once during each six-month period. The terms audit or review are defined in Article X as including an examination of "all books, bills, receipts, vouchers and records, bonds, securities or other evidences of ownership to property or investments."

[EXHIBIT 17:IBT Blowup/Chart 09 - IBT Organization]

IV. Internal Affairs & Matters

At least on paper, in 1992 both the IRB and the Trustees had oversight responsibilities related to the Teamster's financial affairs-- safeguards over the General President and the General Secretary-Treasurer. This oversight was important in view of the 'blank check' provisions given for lobbying and other political purposes and the **General President's** direct authority over a number of critical departments including communications, legal, legislative and political action, and organizing.

[EXHIBIT 18:IBT Blowup/Chart 10 - Departments]

To date, the correspondence and documents reviewed show that beginning as early as 1993 the International Trustee's oversight was undermined by the actions of the senior Teamster officers. The **General Secretary-Treasurer**, Tom Sever, who under the Constitution had "primary responsibility for payments from the general fund for all financial obligations, commitments and expenditures of the International Union" obstructed the International Trustees through various tactics some of which included: (1) failure to provide requested documentation, (2) denial of access to personnel for interviews and underlying files, (3) refusal to permit copies of relevant materials to be made, and (4) selective use of other tactics such as the exclusion from Board meetings. These are the same tactics currently being used to obstruct the work of this Subcommittee.

By 1994 the International Trustee's oversight would become ineffective notwithstanding the involvement in the Teamster's affairs of the IRB and the Department of Justice. In 1995 the

International Trustees, lacking the authority they believed was provided to them under the Constitution, approached the IRB for assistance. The resulting inaction set the stage for the lack of accountability, absence of reporting and the improper use of union funds in 1996.

V. Financial Reporting

Materials examined also show that as early as 1994 concerned union members sought information from the LM-2's, the Annual Reports required to be filed with the Department of Labor. Financial information is suppose to be meaningful and useful. These concerned individuals found the information not useful as it was inadequate to assess what monies were spent on various Union activities. For example, travel expenses were not reconcilable to the amounts reimbursed and disbursed to employees for travel. Corporate Teamster charge cards were being used for travel although the expenses related to this travel were not were attributable to Teamster officers and employees. In 1996 more than $4 million was spent on travel.

From my own review, I have found the LM-2's to be neither comprehensive nor complete. For example, there is little if any information on the use of monies related to the "General," "Special Organizing," or "Defense" funds despite tens of millions of dollars that passed through these funds over the years. Other deficiencies exist. The LM-2 dollar amount of expenditures related to the 1996 convention are inconsistent with other available information -- the 1996 audited financial statements show convention expenses of $7.3 million while the convention costs included in the LM-2 total only $3.5 million, an unexplained difference of $3.8 million.

Meaningful financial reporting also deals with timeliness of information. In February 1998, when I sought a copy of the most recent financial information available at the Department of Labor on a Teamsters Pension Plan, I received and was charged for a copy of the most recent available report -- a report containing financial information as of December 31, 1994, information over three years old.

The **Objectives of Financial Reporting by Nonbusiness Organizations** issued by The Financial Accounting Standards Board maintains that financial information is useful in (1) making resource allocation decisions, (2) assessing services and the ability to provide services, (3) assessing management stewardship and performance.

Inadequate and untimely information does not provide such information.

* * *

Since January 1, 1992 the Teamsters Union has reached the brink of insolvency with a loss of over $155 million. Factors that contributed to this include inadequate and ineffective accountability, reporting and oversight.

The Financial Accounting Standards Board views governing and oversight bodies at nonbusiness organizations as being responsible for (1) for setting policies, overseeing and appraising managers, and (2) reviewing the organization's conformance with various laws, restrictions, guidelines, or other items of a similar nature. The United States Sentencing Commission Guidelines Manual states that an "effective program to prevent and detect violations of law" means a program that has been reasonably designed, implemented, and enforced so that it generally will be effective in preventing and detecting criminal conduct.

To date I have learned of no evidence that (1) the Teamsters had compliance standards and procedures, or that (2) any standards or procedures were communicated to union officers, employees, rank-and-file members and agents, or that (3) any steps were taken to assure compliance with any program. The 'quick-fix' of the Consent Decree did not do the job.

Between 1992 and 1996, Ron Carey was accountable to no one but himself for many expenditures. The result was that neither the Union rank-and-file workers nor the American taxpayers were protected. I've identified some of the 1996 costs which total more than $38 million. The components of this $38 million are: Union election at a taxpayer cost of approximately $20 million; unexplained increases totaling more than $13 million paid by the Union treasury; and more than $5 million relating to the IRB also paid with Union funds.

It is likely that the financial and managerial crises could have been mitigated, if not averted, had proper safeguards been in place. The cost of this failure is not only a monetary loss as a result of tens of millions of dollars that have been spent on ineffective efforts but also a loss of the credibility of the government involving a process that should have worked but did not.

THANK YOU, MR. CHAIRMAN.