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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

UNITED STATES OF AMERICA,

Plaintiff,

v.

JOSEPH H. SMITH, and
ANTON ZGOZNIK,

Defendants.

I N D I C T M E N T

1:06cr00394

CR. NO.

Title 18, United States Code,
Sections 371, 1341, 1346, 1349, and
1956(a)(1)(B)(i);
Title 26, United States Code, Sections
7206(1), 7206(2), and 7212(a)

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JUDGE ALDRICH

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GENERAL ALLEGATIONS

The Grand Jury charges:

The Catholic Diocese of Cleveland ("Diocese") and related entities

At relevant times:

1. The Catholic Diocese of Cleveland ("Diocese") was an Ohio charitable trust which operated, supervised, and/or provided services to numerous Catholic organizations and institutions (hereinafter "constituent organizations") within an eight-county geographical area in the north-central part of Ohio. The administration of the Diocese was organized by major areas of responsibility into administrative components, mostly designated as Secretariats, each headed by a Secretary or other senior official appointed by the Bishop. One of the administrative components was the Financial and Legal Office, headed by the Financial and Legal Secretary. The Bishop and auxiliary bishops had supervisory authority over the Secretaries and other senior officials.
2. The Diocese had a Diocesan Financial Advisory Committee (also referred to as the Advisory Council or Canonical Advisors), presided over by the Bishop or his delegated representative, consisting of lay persons appointed by the Bishop, which had responsibilities for advising the Bishop and the Financial and Legal Secretary on financial matters and approving certain Diocese expenditures.
3. The Catholic Cemeteries Association ("CCA") was a separate corporate entity from the Diocese, the operations of which were under the supervisory authority of the Diocese Financial and Legal Office.

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4. The Borromeo Seminary, St. Mary's Seminary, and the Center for Pastoral Leadership (also jointly hereinafter "the Seminaries") were each separate corporate entities from the Diocese, under the supervisory authority of the Diocese Secretariat for Clergy and Religious.

5. The Office of Education was a Secretariat of the Diocese, the responsibilities of which included supervision over nine Diocesan-owned high schools.

Defendant JOSEPH H. SMITH and related entities

6. Defendant JOSEPH H. SMITH ("SMITH") was employed by the Diocese in the Financial and Legal Office from the early 1980s through February 17, 2004. During the relevant time period, he initially held the positions of Treasurer and then Chief Financial Officer ("CFO"), with principal responsibilities for the Diocese Finance Office under the supervision of the Financial and Legal Secretary. In approximately mid-2000, he was promoted to be Financial and Legal Secretary, while continuing to maintain the position of CFO. During the relevant time period, he was a licensed attorney and a certified public accountant ("CPA") and resided in Westlake and then Avon Lake, Ohio.

7. Upon becoming Financial and Legal Secretary, SMITH's compensation was determined annually by the Bishop, upon recommendation of the Diocesan Financial Advisory Committee.

8. SMITH was also a member of the Boards of Trustees of the Catholic Cemeteries Association, the Center for Pastoral Leadership, and the Borromeo and St. Mary Seminaries.

9. In his employment at the Diocese, SMITH had a duty to provide honest services to the Diocese, its constituent organizations, and the members of the public to whom the Diocese had a fiduciary duty as a charitable trust.

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10. **Tee Sports, Inc.** At all relevant times, SMITH was the sole owner and operator of a corporation known as Tee Sports, Inc. ("Tee Sports"), which was engaged in the business of selling golf paraphernalia and other items and occasionally consulting on the operation of golf outings. SMITH disclosed his ownership of Tee Sports and its above-described business activities to Diocese officials and the Financial Advisory Committee, representing that he conducted Tee Sports business from his home primarily during evenings and weekends.

11. SMITH prepared and filed corporate income tax returns for Tee Sports, Inc., as a taxable entity through the year 2002. For the year 2003, he elected Subchapter S corporation status for Tee Sports, Inc., making the corporation's income reportable on his personal tax returns on a flow-through basis.

12. **JHS Enterprises.** SMITH used the name JHS Enterprises to receive and disburse funds for various purposes. JHS Enterprises did not have an independent legal existence. SMITH reported certain financial transactions using the name JHS Enterprises on Schedule C of his personal income tax returns, as a purported sole proprietorship business.

13. At all relevant times, SMITH maintained a bank account in the name of JHS Enterprises at Provident Bank (account number ending "547" -- hereinafter the "JHS Enterprises Account").

14. On or about March 31, 1999, SMITH applied for P.O. Box 40092, in Bay Village, Ohio, in the names of JHS Enterprises and Tee Sports, which he maintained at all relevant times thereafter.

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Defendant ANTON ZGOZNIK and related entities

15. From approximately October 1995 through January 1997, defendant ANTON ZGOZNIK performed services for the Diocese in the Financial and Legal Office as an independent contractor. From approximately February 1997 through January 1999, he was an employee of the Diocese, in the Financial and Legal Office, holding the position of Assistant Treasurer. From approximately February 1999 through the end of 2003, ZGOZNIK continued to serve as Assistant Treasurer on an "outsourced" basis through an agreement between the Diocese and certain accounting and consulting firms he controlled.

16. During the period from approximately October 1996 through at least December 2003, ZGOZNIK was the principal or sole owner of a number of corporations, which provided accounting, tax, financial, and computer technology services, with the principal clients being the Diocese and certain of its constituent organizations. The corporations, which will also be referred to herein collectively as the "ZGOZNIK Entities," are described as follows:

ZJ & Associates, Inc. ("ZJA"), later re-named Institutional Financial Advisors, Inc. ("IFA")

a. On approximately October 1, 1996, ZGOZNIK and Zrino Jukic established a business known as ZJ & Associates, Inc. ("ZJA"), located in Mentor, Ohio. SMITH did the legal work to incorporate the business for them. In December 2001, the corporation's name was changed to Institutional Financial Advisors, Inc. ("IFA"). The corporation will also be referred to herein as "ZJA/IFA."

b. Throughout the existence of ZJA/IFA, Jukic was held out to be the President and owner of the company, with the initials "ZJ" supposedly representing Jukic's

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name, when, in fact, ZGOZNIK was the true owner and exercised the principal control over the company. In approximately late 2002, Jukic's active relationship with IFA ended.

Institutional Business Systems, Inc. ("IBS"), and its predecessor entities

c. On approximately July 1, 1999, ZGOZNIK incorporated Monastra & Associates, Inc. In April 2001, ZGOZNIK renamed the corporation Zgoznik & Associates, Inc. In February 2003, he again renamed the corporation Institutional Business Solutions, Inc. ("IBS"). ZGOZNIK initially had a 99 percent ownership and later became the sole owner.

d. During most of its existence, IBS and predecessors did business as a public accounting firm. Beginning in early 2003, ZGOZNIK stopped using IFA as a business entity and began using IBS to provide the same consulting/accounting services to the Diocese and constituent organizations that ZJA/IFA had provided. In 2003, ZGOZNIK also used IBS to provide computer technology services.

Alexander Systems Group, Inc.

e. On approximately July 1, 1999, ZGOZNIK incorporated Alexander Systems Group, a computer technology consulting business for which he was the sole owner. In February 2003, he changed the name of the corporation to Zgoznik and Associates, Inc. (at the same time the corporation previously using that name became IBS).

Diocese Outsourcing of Services to the Zgoznik Entities

17. From early 1996 through December 2003, SMITH caused and induced certain offices and departments of the Diocese and certain of its constituent organizations, including but not limited to the CCA, the Seminaries, and the Diocesan-owned high schools, to retain the services of the Zgoznik Entities to perform accounting, computer, financial, and other related

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services, including outsourcing of certain functions previously performed in-house by the Diocese and those constituent organizations. The Diocese, CCA, Seminaries, and Diocesan-owned high schools together paid approximately the following amounts to Zgoznik Entities during these years:

Year	Amounts paid by the Diocese and constituent organizations to the Zgoznik Entities
1996	\$12,090
1997	\$618,378
1998	\$1,263,447
1999	\$2,048,588
2000	\$2,867,345
2001	\$3,190,567
2002	\$3,819,699
2003	\$3,713,216
TOTAL	\$17,533,330

Kickback Scheme with the Zgoznik Entities

18. From approximately June 1997 through February 2004, ZGOZNIK and SMITH devised and executed a scheme to defraud and to obtain money by false and fraudulent pretenses, representations, and promises, by which SMITH, in violation of his duty of honest services to the Diocese, its constituent organizations, and the members of the public to whom the Diocese had a fiduciary duty as a charitable trust, and to the financial detriment of the Diocese and its constituent organizations, steered substantial business to the Zgoznik Entities in consideration for which and while receiving substantial undisclosed kickback payments from ZJA, IFA, and IBS -- as described in more detail in the following paragraphs.

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19. SMITH caused and induced the Diocese and certain of its constituent organizations to retain and pay the Zgoznic Entities to perform outsourced services, without disclosing on the records of the Diocese or to officials responsible for finances of the Diocese and the constituent organizations that he was receiving substantial kickbacks from certain of the Zgoznic Entities, namely, ZJA, IFA, and IBS.

20. The Zgoznic Entities billed and received payments from the Diocese and constituent organizations for the outsourced services. In many instances, particularly with respect to the billings to and payments by the CCA, the Seminaries, the Office of Catholic Education, and some Diocese-owned high schools, the billings and payments were sent by U.S. mail.

21. ZGOZNIK and SMITH caused the Diocese and constituent organizations to pay for more outsourced services by the Zgoznic Entities and to pay higher costs for the outsourcing than they would otherwise have paid in order to generate funds to pay the kickbacks to SMITH.

22. In at least one instance in 2002 and on some invoices in 2003, ZGOZNIK caused invoices from a Zgoznic Entity to the Diocese to inflate the amount billed for purported services to the Diocese by an amount to cover the next kickback check paid to SMITH.

23. SMITH and ZGOZNIK disguised the kickback arrangement by having ZJA, and later IFA and then IBS, pay the kickbacks by checks payable to JHS Enterprises and Tee Sports, Inc., for purported business services. The kickbacks were paid in the following yearly amounts:

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Year	Checks payable to JHS Enterprises	Checks payable to Tee Sports, Inc.	Total
1997	\$38,050.00	none	\$38,050.00
1998	\$101,735.00	none	\$101,735.00
1999	\$77,963.75	\$33,634.00	\$111,597.75
2000	\$86,375.00	\$106,932.00	\$193,307.00
2001	\$112,752.50	none	\$112,752.50
2002	\$83,650.00	\$31,260.00	\$114,910.00
2003	none	\$112,275.00	\$112,275.00
Total	\$500,526.25	\$284,101.00	\$784,627.25

24. ZGOZNIK caused the kickback payments from his entities to be falsely recorded on the books and records of those corporations as being payments for purported legal, consulting, and other services which SMITH and his business entities did not, in fact, render to those ZGOZNIK entities.

25. In many instances, false and fictitious invoices from Tee Sports, Inc., and JHS Enterprises were prepared and maintained in the records of ZJA and IFA for purported legal, consulting and other services, which SMITH and Tee Sports, Inc., did not, in fact, perform, as documentation to conceal the true nature of the kickback payments.

26. SMITH deposited the kickback checks payable to JHS Enterprises into the JHS Enterprises Account and recorded the deposits on a register he maintained for that account as consulting income.

27. On or about May 3, 1999, SMITH opened a bank account in the name of Joseph H. Smith, DBA Tee Sports, Inc., at Fifth Third Bank (account number ending "739" -- hereinafter the "DBA Tee Sports Account"). SMITH listed the federal tax identification number

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for the corporation, Tee Sports, Inc., on the account opening document. SMITH made the initial deposit with the first kickback check from ZJA payable to Tee Sports, Inc. SMITH thereafter deposited all but two of the kickback checks payable in the name of Tee Sports, Inc., into the DBA Tee Sports Account. At all relevant times, SMITH used the DBA Tee Sports account primarily or exclusively for personal purposes, and not to conduct the legitimate business activities of Tee Sports, Inc.

28. During 2003, SMITH misled the Diocesan Financial Advisory Council by misrepresenting the amount paid by the Diocese to the Zgoznic Entities for outsourced services.

29. During early 2004, after the Diocese received anonymous information of the payments to SMITH from the Zgoznic Entities:

a. ZGOZNIK misled the Diocese by presenting false and misleading documents that concealed the kickback arrangement with SMITH and the inflating of certain invoices to cover kickback payments to SMITH, and

b. SMITH misled the Diocese by falsely representing that payments he received from the Zgoznic Entities were for actual services he had rendered to those entities.

The DOC Fidelity Account Scheme

30. In approximately March 1996, an arrangement was made between SMITH and the then Financial and Legal Secretary, for SMITH to be paid a substantial lump-sum payment, in addition to his regular salary, in order for him to remain at the Diocese, rather than seeking a more lucrative position in the private sector. The understanding was that the payment would be in lieu of any additional raises for the next five years, other than cost of living increases.

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ZGOZNIK participated in the arrangement by helping to urge the Financial and Legal Secretary to agree to the payment and by helping transfer the Diocese funds under the arrangement.

31. To effectuate the above arrangement, a not-for-profit organization account was set up at Fidelity Investments using the tax identification number of the Diocese, under the account name "D.O.C. Special Administration" (hereinafter the "DOC Fidelity Account"), with SMITH and the Financial and Legal Secretary as the authorized individuals to transact business, using SMITH's home address as the mailing address. The account was opened on approximately April 1, 1996, with an initial deposit of \$185,000, made by a Diocese check payable in that amount to Fidelity Investments. A purported memo to Smith was created, stating that the \$185,000 was being transferred into "a Special Administration account held outside of the Finance Office to handle sensitive items impacting the Diocese."

32. In August 1997, SMITH and ZGOZNIK caused an additional \$85,000 of Diocese funds to be deposited into the DOC Fidelity Account by another Diocese check.

33. No formal entries were made on the Diocese records to reflect that SMITH received the \$270,000 as compensation, and the Diocese did not report the benefit SMITH received from this account to the Internal Revenue Service ("IRS") on any tax reporting form.

34. At all times, SMITH used the DOC Fidelity Account as a personal investment account, through which he received the entire benefit of the \$270,000 of Diocese funds deposited into the account. He made purchases and sales of stocks and other securities and periodically withdrew funds from the account for personal expenditures through approximately August 2002, when the account was left with a minimal balance. SMITH, however, did not report the \$270,000 deposited into the account, his receipt of funds withdrawn from the account, or any

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dividends, capital gains, or other income generated from account activity on his federal income tax returns.

Payments to SMITH through the Catholic Cemeteries Association ("CCA")

35. In January of 1997, 1998, 1999, and 2000, SMITH, without authorization, caused Diocese funds to be paid to him, indirectly by checks from the CCA to JHS Enterprises, as follows:

36. In January of each of the four years 1997 through 2000, SMITH caused the CCA to issue a check payable to JHS Enterprises, which he deposited to the JHS Enterprises Account. The 1997 check was in the amount of \$12,500; in each of the other three years the check was in the amount of \$15,000. Each check was recorded on the books of the CCA as being for executive and professional services.

37. Following the issuance of each check, SMITH caused the Diocese Finance Office to issue a check in the same amount payable to the CCA. Each check was recorded on the books of the Diocese Finance Office as a reimbursement of part of the yearly fee (or "administrative tax") the Diocese charged the CCA for Diocesan services.

38. No formal entries were made on the Diocese records to reflect that SMITH received the yearly payments from the CCA as compensation, and the payments to SMITH were not reported to the IRS by either the Diocese or the CCA on any tax reporting form.

39. SMITH concealed and disguised his receipt of the CCA January payments by not reporting the income on some of his federal income tax returns and by including the amount in the gross receipts reported on the JHS Enterprises Schedule C on at least one of his returns.

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SMITH's Kickback Scheme with an Insurance Brokerage Firm

40. During the relevant time period, SMITH arranged for the Diocese to retain the Cleveland office of an insurance brokerage firm ("Insurance Firm") to provide periodic insurance consulting services to the Diocese and to serve as a broker for obtaining certain insurance coverage for the Diocese.

41. Beginning in approximately May 1994 and continuing through approximately December 2000, SMITH, without Diocese authorization, received monthly kickback payments from the Insurance Firm, by checks payable to JHS Enterprises. The monthly payments were in the amount of \$833 until approximately May 1998, when they increased to \$1,250.

42. Until approximately May 1998, the monthly payments were recorded on the books of the Insurance Firm as being for supposed consulting services provided by SMITH to the Insurance Firm, even though SMITH provided no regular monthly services.

43. In approximately May 1998, SMITH and an Insurance Firm executive signed a purported lease agreement, seemingly providing for the Insurance Firm to lease a condominium SMITH owned at the Saddlebrook Resort in Tampa, Florida, at monthly lease charge of \$1,250. Despite the purported lease, Smith kept full control over the condominium.

44. SMITH concealed and disguised his receipt of the kickback payments from the Insurance Firm by not reporting the income on some of his federal income tax returns and by including the amounts in the gross receipts reported on the JHS Enterprises Schedule C on at least one of his returns.

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STATUTORY CHARGES

COUNT 1

**Conspiracy to Commit Mail Fraud, 18 U.S.C. §§ 371 and 1349
Defendants: JOSEPH H. SMITH and ANTON ZGOZNIK**

The Grand Jury further charges:

1. The allegations in paragraphs 1 - 29 of the General Allegations are re-alleged and incorporated by reference in this count, as though fully restated herein.
2. From approximately June 1997 through February 2004, the exact dates unknown to the Grand Jury, in the Northern District of Ohio, Eastern Division, and elsewhere, the defendants, JOSEPH H. SMITH and ANTON ZGOZNIK, did unlawfully, willfully and knowingly, conspire, combine, confederate, and agree together and with each other and with others, both known and unknown to the Grand Jury, to commit offenses in violation of Title 18, United States Code, Sections 1341 and 1346, to wit, mail fraud.
3. The object of the conspiracy was to devise and execute a scheme and artifice to defraud the Diocese, its constituent organizations, and the members of the public to whom the Diocese owed a fiduciary duty and to obtain money from the Diocese by means of false and fraudulent pretenses, representations, and promises, to wit, the Kickback Scheme with the Zgoznic Entities alleged in paragraphs 18 - 30 of the General Allegations.

Manner and Means of Carrying Out the Conspiracy

4. The manner and means of carrying out of the conspiracy included, but were not limited to, the conduct alleged as the Kickback Scheme with the Zgoznic Entities in paragraphs 18-29 of the General Allegations.

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Overt Acts

On and after July 30, 2002, in furtherance of the conspiracy, and to effect its illegal objects, the following overt acts, among others, were committed in the Northern District of Ohio, Eastern Division, and elsewhere:

5. On approximately a monthly basis during the period from July 30, 2002, through December 31, 2003, the Zgoznic Entities sent invoices for outsourced services to the Diocese, components of the Diocese, and constituent organizations, at the Diocese office in Cleveland, Ohio.

6. On approximately a monthly basis, during the period from July 30, 2002, through December 31, 2003, the Zgoznic Entities sent invoices for outsourced services by United States mail to the following Catholic organizations or institutions, at the addresses indicated below:

	Entities issuing the invoices	Entities Receiving the invoices	Address
a.	Alexander Systems Group ("ASG"), IFA, and IBS	Catholic Cemeteries Association ("CCA")	10000 Miles Avenue, Cleveland, Ohio 44105
b.	IFA and IBS	St. Mary Seminary, Borromeo Seminary, and Center for Pastoral Leadership	28700 Euclid Avenue, Wickliffe, Ohio 44092

7. From August 2002 through December 2003, the Diocese sent checks to the Zgoznic Entities in payment of invoices for outsourced services.

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8. From August 2002 through December 2003, defendants SMITH and ZGOZNIK and co-conspirators, the following Catholic organizations or institutions sent checks by United States mail to the following Zgoznik Entities at 7325 Production Drive, Mentor, Ohio, in payment of invoices for outsourced services, indicated below:

	Catholic organization or institution issuing the checks	Zgoznik Entities to which the checks were payable
a.	CCA	ASG, IFA, and IBS
b.	Center for Pastoral Leadership, in payment of invoices to the Center and to the St. Mary and Borromeo Seminaries	IFA and IBS

9. From August 2002 through December 2003, defendant ZGOZNIK made kickback payments to SMITH by issuing and causing to be issued checks from IFA and IBS payable to JHS Enterprises and Tee Sports, some of which were addressed to P.O. Box 40092, Bay Village, Ohio, as follows:

- a. Three checks dated from August 19 through October 16, 2002, from IFA to JHS Enterprises, totaling \$24,675.
- b. Six checks dated from December 3, 2002, through March 25, 2003, from IFA to Tee Sports, totaling \$55,235.
- c. Nine checks dated from May 2 through December 29, 2003, from IBS to Tee Sports, totaling \$73,300.

10. On or about January 6, 2004, SMITH made false representations to a member of the Diocesan Financial Advisors and a Diocese attorney, that the payments he received from the Zgoznik Entities were for actual services SMITH claimed to have rendered to those Entities.

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11. During January or February 2004, ZGOZNIK caused false and misleading written statements to be presented to the Diocese in response to a Diocese request for backup documentation for IBS invoices to the Diocese.

All in violation of Title 18, United States Code, Sections 371, as punishable under Title 18, United States Code, Section 1349.

COUNTS 2 - 9

Mail Fraud, 18 U.S.C. §§ 1341 and 1346
Defendants: JOSEPH H. SMITH and ANTON ZGOZNIK

The Grand Jury further charges:

1. The allegations in paragraphs 1-29 of the General Allegations are re-alleged and incorporated by reference in this count, as though fully restated herein.

Scheme to Defraud

2. During the period from approximately June 1997 through February 2004, the defendants, JOSEPH H. SMITH and ANTON ZGOZNIK, devised and intended to devise a scheme and artifice to defraud and to obtain money by means of false and fraudulent pretenses and representations, to wit, the Kickback Scheme with the Zgoznik Entities alleged in paragraphs 18-29 of the General Allegations.

3. During the periods listed below, in the Northern District of Ohio, Eastern Division, defendants SMITH and ZGOZNIK, for the purpose of executing the aforesaid scheme and artifice, and attempting to do so, would and did place and caused to be placed in a post office and an authorized depository for mail to be sent and delivered by the United States Postal Service and would and did cause to be delivered by the United States mail according to the directions thereon, envelopes containing the items listed below, which were addressed as stated below:

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COUNT 2: For the period from approximately July 30 to December 31, 2002, envelopes containing invoices from IFA to CCA, including but not limited to:

Invoice date	Invoice number	Amount
07/30/2002	17160	\$11,283
12/31/2002	17630	\$22,236

COUNT 3: For the period from approximately August 22, 2002, to February 3, 2003, envelopes containing checks from CCA to IFA, including but not limited to:

Check date	Check number	Amount
08/22/2002	059048	\$11,283
02/03/2003	061373	\$23,236

COUNT 4: For the period from approximately January 31 to October 31, 2003, envelopes containing invoices from IBS to CCA, including but not limited to:

Invoice date	Invoice number	Amount
01/31/2003	2003FebIBS45	\$11,258
10/31/2003	18583	\$33,748

COUNT 5: For the period from approximately March 10 to December 5, 2003, envelopes containing checks from CCA to IBS, including but not limited to:

Check date	Check number	Amount
03/10/2003	061846	\$11,258
12/05/2003	065099	\$16,083

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COUNT 6: For the period from approximately August 31 to December 31, 2002, envelopes containing invoices from IFA to the Center for Pastoral Leadership, including but not limited to:

Invoice date	Invoice number	Amount
08/31/2002	17313	\$4,000
12/31/2002	17640	\$8,000

COUNT 7: For the period from approximately August 22, 2002, to January 23, 2003, envelopes containing checks from the Center for Pastoral Leadership to IFA, including but not limited to:

Check date	Check number	Amount
08/22/2002	23415	\$6,000
01/23/2003	24231	\$12,000

COUNT 8: For the period from approximately January 31 to November 30, 2003, envelopes containing invoices from IBS to the Center for Pastoral Leadership, including but not limited to:

Invoice date	Invoice number	Amount
01/31/2003	2003FebIBS31	\$4,000
11/30/2003	18622	\$1,000

COUNT 9: For the period from approximately February 24 to December 22, 2003, envelopes containing checks from the Center for Pastoral Leadership to IBS, including but not limited to:

Check date	Check number	Amount
02/24/2003	24423	\$6,000
12/22/2003	26078	\$3,000

All in violation of Title 18, United States Code, Sections 1341 and 1346.