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Occupational Fraud — The 'Grinch' of Businesses

By Pete Miller

One would think that with all the technology in use today companies would be very good at combating fraud. Unfortunately, that's not true. Employee theft alone is costing U.S. businesses $50 billion annually, according to the Statistic Brain Research Institute.

Meanwhile, a study by global specialist insurer Hiscox found that U.S. businesses affected by employee theft, lost an average of $1.13 million in 2016. Small and midsize businesses are hit the hardest, representing 68 percent of the cases, with a median loss of $289,864.

Fraud goes beyond employee theft. It includes e-mail phishing schemes that victimize smart CFOs to fake vendor schemes. No business is immune, whether a huge corporation or mom-and-pop shop. And it lurks in the shadows, hiding until someone suspects trouble, then does the hard investigative work to shine a light on what's really going on.

This article will focus on several types of typical business fraud, and disclose some of the best ways to tease out the details and find the evidence that will hold up in court.

Fraud has evolved over the years. Before electronic communications there were no phishing schemes — the fraudulent email messages that appear to come from a legitimate source, such as a bank or retailer, directing the reader to divulge private information such as passwords or account numbers through a fake website. The fraudsters then use this private information to steal identities, information or money. But even old-fashioned, fake vendor schemes and traditional employee theft are still fairly common.

While technology has led to more opportunities for fraud and theft, it is also helping to prevent it. Companies can turn the incredible amount of data they have into fraud prevention by carefully and proactively monitoring it.

Accounting systems are turning out tons of data that accountants can analyze and look at for anomalies. Data monitoring is one of the most effective, internal control preventive measures available and companies that practice it see a 52-percent reduction over companies that don't, according to the Association of Certified Fraud Examiners (ACFE) "Report to the Nations: 2018 Global Study on Occupational Fraud and Abuse."

It's also good to understand who typically commits financial fraud. Statistics from the ACFE show that individuals in their late 30s to mid-40s make up the largest percentage of fraudsters. At this age they've had enough experience with a company to rise to a level of trust and access, and they have had plenty of time to rack up debt.

Many in their late 30s to 40s have ailing parents, some are facing mid-life crises, others have kids headed toward college. Businesses should understand that just because an employee has been with the same company since age 22 or 23 doesn't mean they can't turn against the employer and do the wrong thing in the right circumstances.

Attorneys often bring in accountants at the point where a company discovers a fraud has occurred, performs an internal investigation on its own, confronts the employee, or starts litigation. They look for an independent third party to sleuth out the facts to help prove the company's assumption.

Forensic accountants often have auditing backgrounds and are experienced at looking to outside sources to find such evidence. Here are several types of examples of how forensic accountants can help legal teams make their case:

Employee Theft

Forensic accountants can help prove when an employee has stolen funds. One initial source of information is the simple check register. Have the top vendors suddenly changed? Has the number of checks written changed? Are checks being written for round dollar amounts? Are they being written on weekends or holidays? Are checks written out of sequence? A yes to any of these questions can signal that something goofy is going on.

Accountants will also look at checks written just below signer thresholds. And then there's "Benford's Law," the principle that in any large, randomly produced set of natural numbers, around 30 percent will begin with the digit 1, 18 percent with 2, and the smallest percentage will begin with 9.

Fraudsters will often find a number they like so that number begins to add up and Benford's Law starts to get out of whack. By crunching the data, forensic accountants can tease out oddities and anomalies that will uncover malfeasance.

Contract Disputes

Sometimes forensic accountants are called in to provide evidence that will help a company in a business dispute. For example, we supported a case where a salesperson at one company signed an agreement that guaranteed a bonus if the company was sold.

The employee was incentivized to stay with the company and would receive the bonus only if the company was sold for greater than a certain amount, based on a convoluted formula. The company didn't want to pay and calculated its value using certain formulas. As representatives for the employee, we were able to dispute the company's calculation and ultimately helped the employee win the bonus he deserved.

Another example involved one business that needed to make payments in advance for products. To enhance his purchasing power, the owner outsourced the purchasing function to the owners of a similar business in a different market. Unfortunately, the owner of the outsourced business placed orders for products for both companies, but paid for all of them out of the other business's bank account.

In addition, suppliers occasionally paid back unused advances. Instead of depositing the money into the payment account, the outsourced businessperson always sent the deposits to his bank account. To prove the fraud, we went outside of both businesses and looked at the account statements from the suppliers to determine where credit was being received and matched up payments on those statements with activity at the bank for each company.

Fake Vendors

This type of fraud occurs when an employee sets up a fake vendor and writes payments to himself through the paper company. It's not unusual for a fraudster to change the address of a "do not use" vendor to his or her own house. We look at two to three years of data and run comparisons of the top suppliers to see how the vendor list has changed and whether the amount spent with those suppliers has changed significantly over the years and why.

To prove this fraud, we contact the employee's bank, get their bank statements and check to see if deposits hit the account around the dates that checks or wires were written to suspect vendors. We also look to see whether the vendor has the same address or P.O. box as the employee writing the checks. We can then run tests against payment data that can point to the appropriate original source documents we need.

Phishing Schemes

In these cases, an outside fraudster sends a fake email asking a high-level employee to click on a link that could launch a virus, seek a wire transfer or even lock down an entire computer system. Here, the best solution is for companies to have processes in place so that this never happens.

It's imperative that companies have IT systems that filter out as much of this spam as possible before it hits an inbox and that they regularly train employees to be aware of these schemes and know what to do if they suspect they've seen one.

Bankruptcy Help

Sometimes forensic accountants are asked to help with bankruptcy cases. We had one example involving an apartment building that was in receivership. The building's property manager ran reports for the landlord that showed vacant units. But the units were actually occupied and when the rent was paid, the property manager kept the rent money.

We determined that the apartments were in fact occupied. We also saw that the property manager was making erratic vendor payments, including some that often were larger than necessary. Working with a legal team, we were able to subpoena the property manager's bank records, which showed he was hoarding the cash.

The best outcomes involve a collaborative effort between the attorney, accountant and business, all working together to find out how the fraud occurred, who is at fault, and to gather the evidence to help the business stop the losses and recover as much as possible. ■

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