



The Fraudster from Within:

By Edward Nagel

The 5 W's of Occupational Fraud

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WHAT Does Occupational Fraud Look Like?

Like many fraud schemes, Mandy Marshall’s* started out with an innocent, “unintentional” error filling out a taxi receipt for \$20 instead of \$10. When the expense report was approved without question, Mandy surmised that the review and approval process by her supervisor was superficial at best.

Facing mounting credit card bills to satisfy what she would later describe to forensic accountants as “retail therapy,” she started submitting personal meals concealed as business expenses by providing only the credit card receipt (and altering the time of the transaction to reflect a lunch). She even created fictitious meeting entries in her Outlook calendar to support her expense claims.

With the passage of time and her scheme seemingly undetected, like most fraudsters, Mandy became more bold and brazen.

Advances were processed through Accounts Payable, while expense reports were processed through Payroll. Mandy would requisition an advance several months prior to an overseas business trip to purchase the airfare. When it came time to prepare her expense report following the completion of travel, she would submit the expenses, but “forget” to offset the advance.

Given the requisition and expense reports were approved by different individuals, the “oversight” was not detected for several months, that is, until an alert colleague suspected the unusual improve-

ment in Mandy’s wardrobe despite her complaints about always being strapped for cash and reported her through the company’s whistleblower hotline.

WHY & How Does Occupational Fraud Occur?

Most organizations today recognize that it’s not a matter of *if* but rather *when* they will be victimized by fraud. But the staggering numbers tell the real story. The RCMP’s Commercial Crime Branch recently released statistics indicating that fraud-related offences in Canada are now thought to be as profitable as drug-related offences, estimated at between \$10 and \$30 billion annually.

While credit fraud, investment fraud, securities fraud and mass marketing fraud continue to dominate headlines, organizations are facing mounting concerns over the prevalence of fraud carried out by their employees. This is commonly referred to as occupational fraud. Payroll fraud is one of the common types of occupational fraud.

According to a recently released occupational fraud survey relating to small and medium-sized entities (SME survey),¹ one quarter (26%) of surveyed SMEs reported to have experienced at least one incident of occupational fraud in the prior fiscal year.

Internal frauds most commonly occur in one of two ways: misappropriation of assets or fraudulent financial reporting. While payroll fraud can theoretically fall under both categories, misappropriation tends to be the quickest and most common way for a fraudster to extract funds from an organization through payroll.

Payroll fraud schemes generally fall under one of four categories: the creation of fictitious or “ghost” employees; false wages/benefits fraud; workers’ compensation fraud; and false expense reimbursement fraud. (These payroll fraud types are discussed in detail in Nagel’s article, “*Padding the Payroll: How to Detect and Prevent Fraud*,” published in the July/August 2010 issue of *DIALOGUE*.)

WHO is a Typical Fraudster?

Statistics and profiling based on debriefing the findings of actual investigations conducted can be helpful in providing us with character traits about fraudsters. However, as a fraudster’s objective is to not get caught, caution should be exercised in relying solely on these generalized indicators.

The typical profile of a fraudster is a trusted, senior employee with the authority required to carry out the illicit transactions with little or no involvement of others. They tend to be overly committed, may come across as hostile, and fail to seek assistance when overwhelmed with work.

You tend to find these individuals living beyond their means and experiencing financial difficulties. They could be dealing with an addiction and may openly express discontent about their compensation. Some fraudsters may even

**Names and details have been changed for all case studies.*

¹ “Does Canada Have a Problem with Occupational Fraud”, *Certified General Accountants Association of Canada*

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forget about discretion regarding their sudden rise to wealth and leave a trail of suspicion about the source of their newly found lifestyle—such as Mandy Marshall.

Regardless of the driver, there's a trigger causing the honest employee to become a desperate one. An Association of Certified Fraud Examiners fraud survey² found that 85% of fraudsters were never charged or convicted for fraud, which appears to suggest that these are not necessarily career criminals, per se, but rather individuals driven to commit fraud for a specific cause.

WHERE Are the Red Flags of Fraud?

Beyond looking out for changes in our colleagues' behaviour and character, there are indicators at various stages of the payroll process that should be sending red flags. This list, while not exhaustive, includes the following factors to look out for:

- Employees with duplicate addresses and/or bank account information
- Expense reports with photocopied/ altered receipts, calculation errors and supporting documentation lacking details of expenses incurred;
- Invalid social insurance numbers;
- Employees without source deductions and/or employee files;
- Employees who have recurring workplace injuries that conflict with known activities outside of work;
- Fluctuations in payroll expense as compared to prior periods, including inconsistencies between the level of payroll and department productivity; and, Timesheets with notations in dif-

ferent handwriting or colour.

WHEN Should I Be Suspicious?

This is a common question asked of forensic accountants. My response: Strong internal controls that are regularly tested coupled with periodic fraud awareness training and an independent whistleblower hotline mean this question rarely needs to be asked. Through fraud awareness training, staff can learn how to detect and report fraud, and when suspected, they will have the confidence to report fraud through an independent whistleblower hotline without fearing retribution.

Protecting Your Organization against Fraud

Fifty-nine per cent of the SME survey's respondents stated they do not undertake periodic risk assessments of occupational fraud; 80% reported they do not have a fraud response plan; and 11% said they do not use any fraud detection measures. Moreover, almost 20% reported that the resources they allocate to prevention and detection of occupational fraud have noticeably declined in the past three years.

Internal controls are integral to mitigat-


ing fraud. Most organizations have policies and procedures that indicate how transactions are to be carried out. Best practices support employees reviewing such policies on at least an annual basis, receiving training, and signing off that they have read and understood all key policies.

Moreover, whistleblower hotlines are an integral component of an organization's fraud management framework. Organizations such as The Listening Post (www.thelistpost.com) offer an independent, confidential mechanism for individuals—both internal and external to organizations—to report suspicious activity, including fraud.

If fraud is suspected in your organization, management should proceed prudently and with the appropriate professional advice to prevent more loss. Preservation of evidence becomes




² Association of Certified Fraud Examiners 2010 Report to the Nation on Occupational Fraud and Abuse



crucial, but it must be collected and analyzed properly to be admissible in legal proceedings.

Fraud will undoubtedly continue to be ranked amongst the top 10 “stay awake” issues for management and boards alike. But if a policy of zero tolerance is clearly communicated and fraud is kept top of mind, fraudsters will think twice before preying on your organization. ■

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