7 Simple Steps to Corporate Fraud Prevention: A Case Study

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The shock when a victim discovers that a trusted employee – and even a friend – has stolen from him or her is absolute. It's a feeling of betrayal and violation that strikes fear in some, grief in others and anger in most.

In my experience, it is almost always accompanied by a sense that the victim should have known it was going on. The evidence of theft sheds a bright light in the rear-view mirror. Patterns and circumstances take on a clarity that contemporaneous experience obscured. Sometimes the clarity was there but for a variety of reasons it was ignored.

A Case Study

A victim uncovered theft when his bookkeeper unexpectedly missed a few days of work and he opened a bank statement. The simple act of thumbing through cancelled checks from one month's bank statement prompted a phone call to his attorney who directed him to a forensic accountant. The internal fraud was revealed, he felt stupid for allowing it to happen and the lesson cost him several hundred thousands of dollars in uninsured losses.

The forensic accountant uncovered evidence of a simple but effective embezzlement scheme. The bookkeeper had set up vendors that were very similar to existing real vendors. For example, if the real vendor was ABC Service Company then a fake vendor was established called ABC Service Co. The bookkeeper set up bank accounts for the fake vendors. That was the hard part. The rest was easy. The business owner signed hundreds of checks to the fake vendors thinking the checks went to legitimate business activity.

Since that worked so well, the bookkeeper began forging checks to pay the vendors, personal expenses, and provide cash gifts to family and friends. And, since all that worked without detection by the business owner, the bookkeeper took an unauthorized increase in salary.

It was bold. It was also easily discovered and should have been easily prevented. The bookkeeper was quickly arrested and has spent time in jail.

Fraud Prevention 101

The following are fraud prevention steps that were ignored and could have prevented the theft:

1. **Know your employee**. In this particular case the business owner recounted that he knew the prior employer of the bookkeeper well. He was aware that the bookkeeper had left the prior employer on less than positive terms but figured it was none of his business and hired the bookkeeper because of knowledge of the industry. A phone call to the prior employer/friend after the embezzlement was

discovered revealed that the bookkeeper was probably stealing from the current employer to pay off a judgment obtained by the prior employer to recover embezzled funds.

2. **Do a background check.** Embezzlers tend to be repeat offenders. This is an obvious follow-up to the prior point. A simple background check is not expensive, is easy to do and, in this case, would have prevented a bad hiring decision. It would have confirmed the ill-at-ease feeling the employer had at the time of hiring.
3. **Open your own mail**. Let the bookkeeper do the bookkeeping. You cannot abdicate other important (and seemingly unimportant) functions because the clerk is always around and does his or her job well. Vendor communications, bank statements, and bills from vendors and suppliers are important sources of information.
4. **Separate functions and duties**. Many small business owners are so busy that they tend to overlook common sense when assigning work. In this case a bookkeeper was eventually given the responsibility for answering the phones, opening all the mail, writing checks, making deposits, preparing invoices, reconciling the bank statements, and preparing the financial reporting provided to the business owner and his outside tax preparer. As noted above, simply opening the mail would have prevented some of the problems – or would have caught it a lot earlier.
5. **Don’t accept bad answers to good questions**. When the forensic accountant arrived on the scene, the business owner requested a report showing payments to all vendors. The bookkeeper had previously argued that it was difficult to put such a report together, would take a long time, and would not be correct. The accountant produced the report in about 90 seconds. The business owner was shocked – and the point was made. His bookkeeper, for a long time, had prevented him from seeing the very report that exposed the whole scheme.
6. **Force vacations**. Nobody else had access to the bookkeepers work for more than two years. Any other eyes on the accounting records would have exposed everything.
7. **Acknowledge your instinct**. If the lifestyle of the employee exceeds what you know about their legitimate compensation there is good reason to look harder. If the bookkeeper can’t produce simple reports from “the books” they are keeping there is a problem. If you feel like you are working for the bookkeeper rather than them working for you, something is wrong. If it feels like the business is doing better than ever but there isn’t any cash find out why.

All of the steps above were recognized by the business owner in this case: “I knew something wasn’t right. I should have known this was happening.” That is never good after the fact.

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