

Corporate fraud

How to spot red flags that identify potential for theft

INTERVIEWED BY ROGER VOZAR

Corporate fraud and embezzlement isn't limited to high-profile cases where employees buy sports cars and lead a life of luxury.

"That's what people usually think. More often, however, the people who steal are good people who just have an economic need. The corporation provides them with an opportunity to (unlawfully) get the money they need," says Frank A. Suponic, CPA, CFE, CFF, litigation advisory services partner at Skoda Minotti.

Smart Business spoke with Suponic about how fraud is uncovered and what companies can do to protect themselves.

What are red flags that could indicate a fraud problem?

A red flag can be any event in a person's life that would require them to need extra cash — a divorce, illness, bankruptcy filing, taking care of an aging parent or ill child. That doesn't mean that everyone going through divorce or bankruptcy is a thief, but it's something to remember. If suddenly you start having cash flow problems and there's no sound financial explanation for it, you should try to connect the dots, especially if records are incomplete and disorganized or someone is reluctant or has problems getting the information to you.

When you have employee rationalization, opportunity, and economic need or financial pressure, that's the basic recipe for fraud.

Often, fraud is discovered by luck or an anonymous tip. It could be by opening a file and seeing a document that management wasn't supposed to see. Many companies don't like dealing in rumor, but following up on anonymous tips or implementing a whistleblower hotline can

be very helpful for flushing out fraud.

Other than a hotline, what else can companies do to protect against theft?

The top priority is to regularly examine internal controls. Companies cut staff during the recession and may not have as much oversight and proper segregation of duties.

It is important, however, to frequently test the internal controls you do have. There's nothing wrong with a CEO requesting a \$5,000 check from an accounts payable clerk when he doesn't have an invoice to substantiate the payment. Watch the response and see if, and how, the request is handled.

A large part of fraud prevention is being observant and seeing the entire picture. When you know someone has filed for bankruptcy, is driving a new luxury auto, and your corporation has cash flow problems, you may be able to assemble pieces of a puzzle. Those incidents may not mean much when looked at individually, but take on a different perspective when considered in the aggregate.

Thorough background checks also are important. One company thought its controller was an upstanding CPA; they never verified that or knew that he had been convicted for tax evasion. Sadly, he



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was also embezzling. Due diligence at the time of hiring would have uncovered that information before a financial loss.

It's a good practice to annually conduct background checks on employees involved in the cash receipts and cash disbursement processes, not just at the time of hire.

Fraud isn't restricted to people who deal with finances. Salespeople and executives often have economic incentives that may entice them to inflate sales and net income in order to earn a contractual bonus.

A fraud risk assessment can help identify areas of potential concern. They are often eye-opening. If you're worried about cost, start with a single high-risk area like cash disbursements, or cash receipts and accounts receivables, as opposed to covering everything at once.

Management sending employees an anti-fraud message is an effective fraud deterrent. Fraud losses can jeopardize a company's future and employees need to know that fraud is taken seriously.

Fraud comes down to people being greedy or having an economic need, and the corporation rolling out the red carpet by presenting an opportunity. Many internal frauds are not sophisticated. Spending a little time and money on risk assessments and listening to employees can go a long way toward minimizing fraud and embezzlement within a company. ●