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Schemes, Scams & Occupational Fraud

KEY TAKEAWAYS FROM THE CERTIFIED FINANCIAL MANAGEMENT ASSOCIATION'S CONFERENCE

Recently, Husch Blackwell Partners Josh Levy and Eric Meier participated in the Certified Financial Management Association's Midwest Regional Conference in Oak Brook, Illinois. The following is a Top Ten list of takeaways from their topic: "Schemes, Scams & Occupational Fraud."

10. **There is a High Cost of Fraud:** 5% of revenue is lost to internal fraud and abuse each year. The median for construction industry is \$227,000, significantly higher than the median for all industries of \$130,000. There is also the cost of external assistance and the looming potential for higher insurance costs in subsequent years. Additionally, You have to factor in the non-monetary loss to reputation and opportunity costs, which can oftentimes be more damaging.

9. **Recovering Funds is the Exception:** In 53% of the reported frauds, there was no recovery—money was often gambled away. For 15% of reported frauds where there was a full recovery, the source of recovery was usually an insurance policy.

8. **Insurance Applications Provide Self-Evaluation Check:** Look closely at the Management Liability and Cyber Insurance Applications. They not only speak to the different types of coverages available, but also provide an outline of good thoughts to self-evaluate an internal program. Also, make sure that your actual business practices track your representations on the insurance applications, as inconsistencies could result in coverage denials at the time you

make a claim.

7. **“Cybercrime” Combines Two Distinct Insurance Product Lines:** Cyber coverage traditionally covers risks with privacy and loss or theft of personally identifiable information, while crime coverage usually covers theft of money and certain property. Policy wording and exclusions are designed to keep one policy line from covering risks intended to be covered by another.

6. **Fidelity Bonds Could be a Useful Insurance Tool:** Fidelity Bonds are insurance products which specifically target deceitful acts, not mistakes or oversights. They are commonly designed on a “claims made” basis. There are numerous different types of fidelity bonds—e.g. Business Services Bonds (protects your customers from dishonest acts by your employees) and Employee Dishonesty Bonds (protects employers from their own employees’ dishonest acts like theft, embezzlement and forgery). Specific costs will vary, but a general guideline is that fidelity bonds typically cost anywhere from .5% to 1% of the coverage amount.

5. **There is no Specific Fraudster Profile, but there are some Perpetrator Characteristics:** For good or bad, the United States is not alone in dealing with occupational fraud. According to the Association of Certified Fraud Examiners’ (ACFE) 2018 Global Study on Occupational Fraud and Abuse, data gathered showed occupational fraud occurring in 125 different countries and in 23 different industries. Among the characteristics of perpetrators noted in the study were: (a) a direct correlation between the level of authority and fraud loss; (b) the length of time an employee works for an organization can relate to the likelihood of fraud; (c) the majority of fraudsters were men; and (d) the highest number of fraud acts are committed by those aged 36-45, but the highest dollar amount of loss from fraud acts were committed by those aged 56 or over.

4. **Anti-Fraud Controls for Billing Fraud:** Any scheme in which a person causes his or her employer to issue an irregular payment for goods or services (whether through an inflated or false pay application, change order abuse, billing for costs associated with another project, etc.) is billing fraud. Scrutinizing pay applications helps to not only safeguard against errors, but also helps to address potential fraud. The same is true for change orders, which should include appropriate justification. For example, be mindful of numerous, unusual, or unexplained change orders for a specific subcontractor, which are approved by the same employee.

3. **Red Flags for Expense Reimbursement Credit Card Schemes:** Look for things such as: (a) purchases that do not appear to be business related; (b) original documents supporting expenses are missing; (c) receipts are altered; expenses in round dollar amounts; (d) expenses are just below the receipt submission threshold; and (e) expensive meal expenses lack information as to names/organizations.

2. **Cost Effective Methods to Help Prevent Fraud:** Among the most effective methods to help prevent fraud is to involve numerous employees in the accounting process. Examples include having two staff members review and sign checks over a set amount, and having one employee periodically conduct an independent review of payments to vendors. Also, put in place appropriate segregations of duties.

1. **Hot Lines are the Top Method of Fraud Detection:** The ACFE's 2018 Global Study on Occupational Fraud and Abuse stated that tips from hotlines were the biggest means of fraud detection. Over 40% of all fraud is detected by a tip. Fraud losses are estimated to be 50% smaller for organizations with hotlines than those without.