Steering Clear of Corporate Frauds

An Article By James Chan

How corporates can reduce fraud in their organisations

In 2012, Rita Crundwell, who had been comptroller and treasurer for a small US city Dixon was found to have defrauded the town of almost US$54 million (RM220 million) over 22 years to build an empire of several horse farms and more than 300 championship horses.[1]

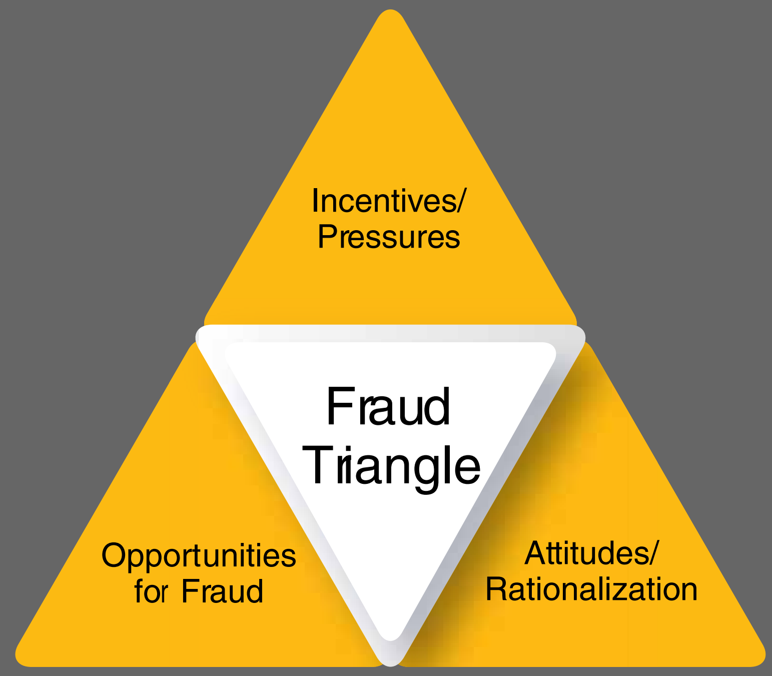
Via fake invoices to transfer city money to her fake city accounts with her name as sole signatory, Crundwell outsmarted auditors, accountants, and city leaders for two decades and pulled off the largest municipal fraud in US history. Crundwell could very well be skiving off millions more to this day if not for a chance holiday and an attentive co-worker.

Say "fraud" and for many, the first names that come to mind are Enron, Madoff, WorldCom or closer to home, 1MDB. But commercial fraud is not just committed by shady financiers and big corporations cooking books, or corrupt politicians 'taking their cut'.

Fraud is common, especially in small businesses where there is overriding management control over finances by one or two people, many of them "trusted" people who have spent years with a company – as Rita Crundwell was seen by townspeople.

Fraud may not be entirely preventable, but there are numerous measures companies can put in place to reduce the probability of commercial fraud.

Before looking at these measures, a good place to start is the Fraud Triangle, which was introduced by American criminologist Donald Cressey in 1973.



Motivation or incentive to commit fraud (i.e. increased debts, desire to be seen as successful, getting away with petty theft creates appetite for larger amounts)

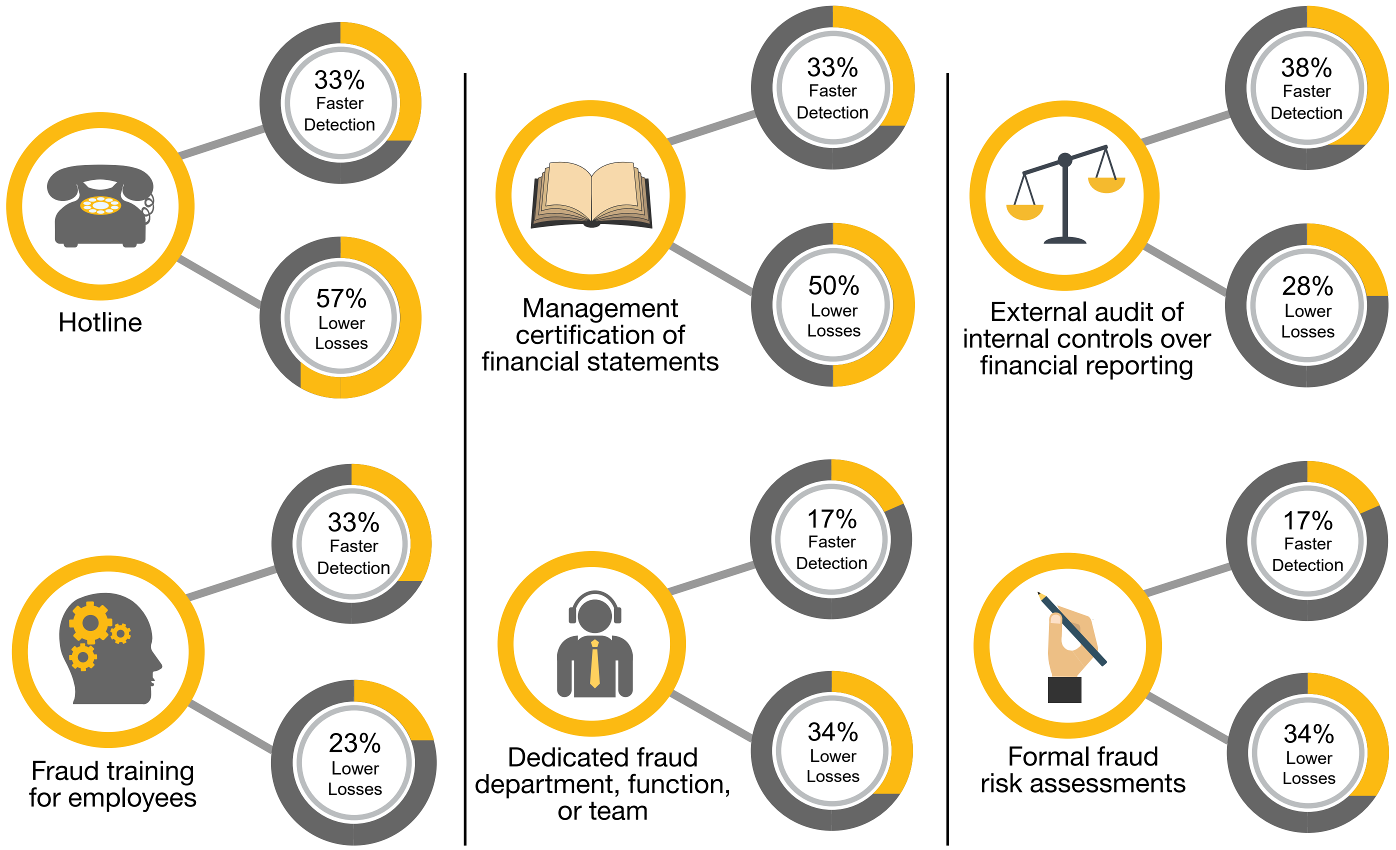
The method by which fraud can be committed (i.e. ability to carry out misappropriation of cash or assets)

Justification of dishonest actions (i.e. "I didn't mean to do it", "Others are doing it too")

Fraud only happens when all three elements are present[3]. Thus, corporations can greatly reduce the likelihood of fraud by removing at least one of these elements.

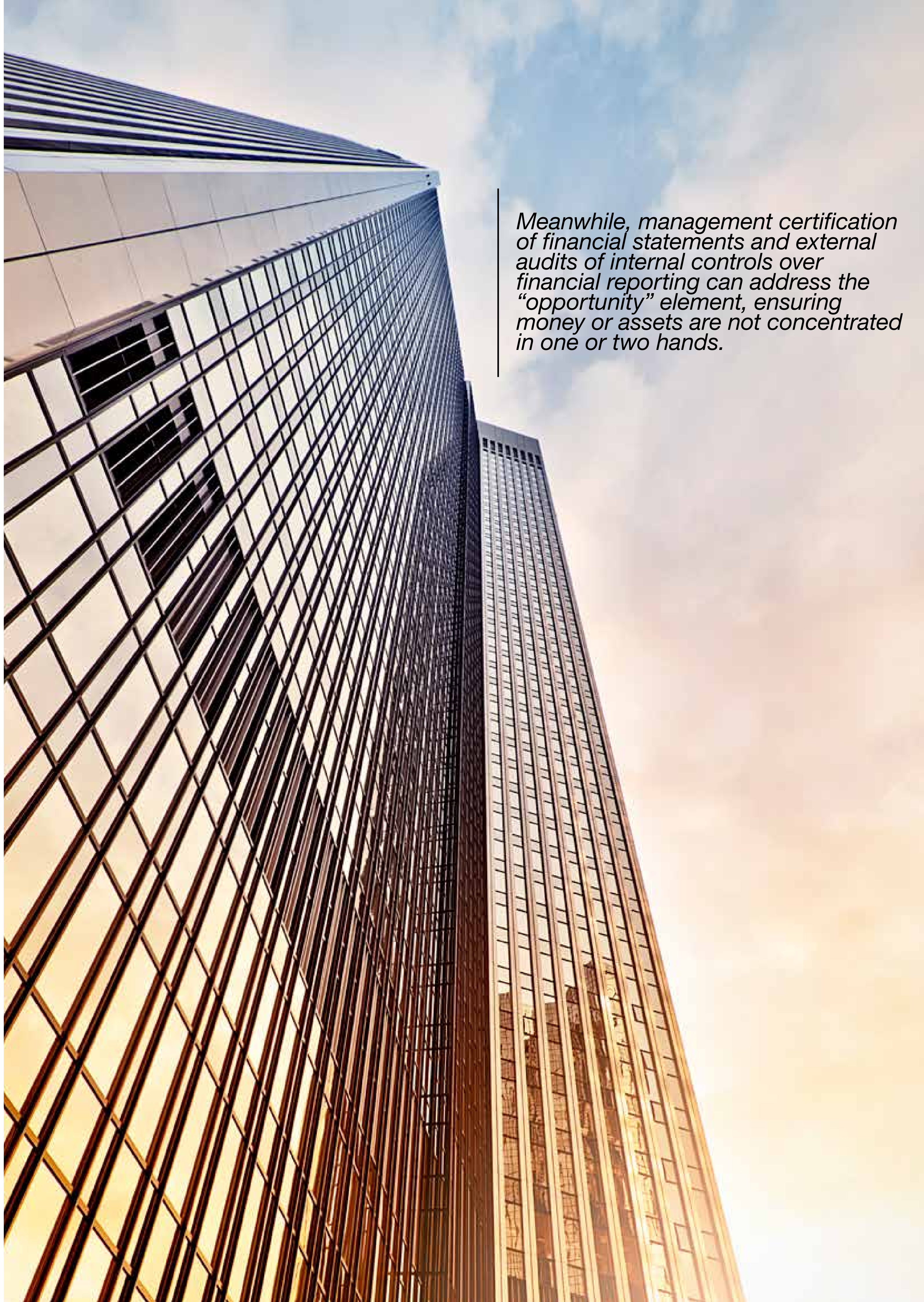
The Association of Certified Fraud Examiners (ACFE) in its 2018 "Report to the Nations: Asia Pacific" study documented 220 cases of occupational fraud in APAC countries (Malaysia: 14 cases) in 2017, with median losses coming to US$236,000 (RM963,000). Fifty-one percent of the schemes were due to corruption, 47% were discovered from tips.

Several anti-fraud control measures have proven successful in faster detection of fraud and lower amount of losses:



These measures address both the rationalisation and opportunity elements of the Fraud Triangle. First, measures like fraud training for employees and a whistleblower hotline help create a healthy corporate culture where fraud is easily detected while reducing the "rationalisation" excuse that other people in the company are doing it too.

Over half (54%) of tips originate from employees – so instead of seeking to control employees, corporations instead should make them the first line of defence. Employees, unlike external parties like suppliers, are more familiar with internal processes and are thus more likely to notice if something is off.



Meanwhile, management certification of financial statements and external audits of internal controls over financial reporting can address the "opportunity" element, ensuring money or assets are not concentrated in one or two hands.

ACFE found that the five most common departments that housed fraud perps were operations and sales (16% each), upper management (11% of cases), accounting and finance (8% each). Simple rules such as designating at least two **signatories** for any company bank account or **segregation of duties** (i.e. a regional procurement centre) can go some way to **creating checks and balances**.

Crundwell amassed a fortune thanks to her ability to open city accounts that only had her name as the lone signatory. This strategy was also carried out by Chia Teck Leong, who swindled four banks of S$117 million (RM352 million) in 3 years as financial manager of Asia Pacific Breweries to pay for his gambling addiction and luxurious lifestyle.5

Another measure to address the "opportunity" element is common in the banking and financial industry but less so elsewhere: **block leave**. This mandatory vacation for employees helps prevent embezzlement. During this time, an employee's duties will be taken over by a colleague and the employee cannot communicate with co-workers.

In 2007, Jérôme Kerviel, a trader at Société Générale, lost over US$7 billion (RM29 billion) of the bank's money. He had not taken one single day of vacation that year because he did not want anyone else to look at his books.6

Crundwell would have continued amassing mares and stallions if not for taking several weeks of leave. During that time, city clerk and whistleblower Kathe Swanson discovered three large deposits in a fake city account in care of Crundwell that had nothing to do with city business. She reported it directly to the mayor, who then notified the FBI.7

The one element corporations may have the least ability to address is the "pressure" element. Nonetheless, the chickens eventually come home to roost and the most practised fraud will grow overconfident and careless and get caught.

Both Chia the compulsive gambler and Crundwell the horse owner were openly lavish with their expenditure, **living beyond their means**. Crundwell's wages amounted to US$80,000 annually and she amassed her ill-gotten gains gradually. Chia, meanwhile, had to feed his gambling addiction and fund luxury car and property purchases and racked up a larger running total in a much shorter time – ringing alarm bells at the Commercial Affairs Department of the Singapore Police Force.

While internal controls may go some way to curbing occurrences of fraud, a transaction review or investigation using analytics by **forensic accountants** such as Crowe can more efficiently identify a failure or breakdown among the procurement to booking life cycle processes.

Not only can a company uncover the areas used to make and hide potential illicit payments, but periodic reviews of the life cycle will also identify gaps in anti-corruption compliance controls and serve as the basis for remediation and improvements.8

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