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Employers Beware! $3.6 Billion in Occupational Fraud to Dramatically Increase During Pandemic

by Neal Levin

A FREEBORN & PETERS LLP CLIENT ALERT

A recent study by the Association of Certified Fraud Examiners reveals that pre-pandemic losses from Occupational Fraud have now topped $3.6B annually. Those losses have been incurred mostly by large corporations, though small, mom & pop and family businesses are also susceptible, as are governmental employers.

Occupational Fraud is defined as: *the use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the organization's resources or assets*. In short, it's an employee stealing from the employer.

Occupational Fraud comes in many forms, such as asset misappropriation, governance corruption and the granddaddy, financial statement fraud, the latter accounting for the greatest total losses.

With the axiom that fraud occurs when "need" meets "opportunity" with a sprinkling of "rationalization" (otherwise known as the Fraud Triangle), it's obvious to see what's coming. Many frauds will be discovered to have been around far in advance of the pandemic. After all, as Warren Buffet says: "when the tide goes out, you see who's been swimming naked." Yet many new fraud schemes are now in the works due to the massive increase in "need."

The timeframe of loss shows that 48% of the cases range from 0-12 months in length before detection, and 35% last 13-36 months. This means that most losses occur in the short term, though left unchecked, the greater the overall loss. Hence, the next 12 months are going to see the greatest uptick by volume.

There are three key phases for any employer relative to Occupational Fraud: Prevention, Detection and Response/Recovery. Most organizations only focus on Response/Recovery due to poor prevention and detection systems in place. In other words, action is taken after it may be too little, too late.

Certainly, Dodd-Frank put some regulations in place towards prevention, including the whistleblower requirements, though these have proven less-than-effective against the whole, as the losses continue to mount. What's more, Dodd-Frank mostly applies to publicly traded companies and is designed to assist the regulators and enforcement agencies that oversee those companies, like the SEC.

Now would be an ideal time for any employer to work on the other two phases, prevention and detection. Prevention can take many forms, such as an overhaul of hiring practices, internal audit protocols and management certification of financial statements. Also, while initial hires may be "clean," the results reveal that some employees "go bad" after hire, especially when there's financial trouble at home. Hence, employee checks, management reviews and external audits are also keys to a strong prevention system. And of course, there's the IT. Vulnerabilities in IT systems have hit every sized employer and could easily have been prevented with IT audits and improved protocols and practices.

Though even the best prevention practices are not foolproof, as fraud is about people, trust, belief and even our own greed, which sometimes leads only to the employment of passive detection systems, which is nothing more than "hoping" that nothing will happen if we cross a few Ts and dot a few Is. A recent client with active wire transfer protocols in place just lost $1.5M to a wire fraud scam. It happens. Therefore, strengthen those detection systems, such as promoting whistleblowers and use of hot lines (external, of course), two and three-factor authentications, regular IT audits and management review.

How Freeborn can help:

- Phase I key person investigations include verification of employment history, education, verification of references and their relationship to the new hire, social media harvest and analytics and where allowed, criminal background and credit checks. On-line "background check" services have often left out key search elements that can reveal risks for your organization.

- Random, post-hire checks will reveal the "red flags" that help identify and shut-down fraud schemes. The most common red flags exhibited by perpetrators include living beyond their means (42%) and having financial difficulties (26%), such as a global financial crisis.

- And should fraud strike, the Global Fraud, Internal Investigations and Asset Recovery Team is ready to help shut it down and pick up the pieces.

If you have any questions, please contact Neal H. Levin ((312) 360-6530; nhlevin@freeborn.com) or another member of Freeborn's Global Fraud, Internal Investigations and Asset Recovery Team.

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Neal Levin is the Team Leader of the Firm's Global Fraud, Investigations and Asset Recovery Team and a member of both the Litigation and Bankruptcy and Financial Restructuring Practice Groups. Neal is also the founder and leader of the Freeborn & Peters Intelligence Unit, which provides intelligence gathering support and analysis for Freeborn clients domestically and internationally.

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