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'Tough' times coincide with rise in fraud

Laying off staff increases a company's exposure to theft, insiders say

By Beth Fitzgerald

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The recession exposes New Jersey businesses to a greater risk of fraud and embezzlement, according to experts, who say as companies shed workers to weather the downturn, there's less staff to safeguard assets, thus making the business more vulnerable to fraud.

"Fraud always exists at some level, but during a difficult economy, it becomes more prevalent — desperate people do desperate things in tough times," said **Michael G. Pane**, who joined the Clifton accounting firm **Sax, Macy, Fromm & Co.** in June as a principal in the firm's forensic, litigation and restructuring group.

"When you lay off employees, you lose elements of control — that double check in the system, where one person can check on another person," said **Henry Fuentes**, a principal in the SMF forensic group. Good internal financial controls require segregation of duties, he said: one person should never be entrusted with every aspect of the company's finances, with no one looking over their shoulder.

Fraud flourishes under three conditions that may be more prevalent in the workplace right now: need, opportunity and justification, said **Joseph T. Shannon**, an SMF forensic principal.

"In these times, there is more financial pressure on the family, and so need arises," Shannon said; maybe the employee's spouse was laid off, and the family can't pay the bills. "Then if there are staff cutbacks, you lose the segregation of duties," thus creating the opportunity for fraud. For example, the same employee may now be writing checks, depositing payments and reconciling accounts.

And if wages are cut back or raises eliminated because the company is struggling, some employees feel justified in stealing. "The employee may think: 'I'm being asked to do more for less, and I'm not being compensated,'" Shannon said.

Ponzi schemes like the multibillion-dollar fraud by jailed financier **Bernard Madoff** typically surface as soon as the stock market nosedives: investors demand their money, and the fraud collapses. But the garden-variety inside job by an employee who steals and then papers over the theft with phony documentation can take 18 to 24 months to detect, Fuentes said.

Sharon Bromberg, forensic accountant and partner at **J.H. Cohn**, in Roseland, said the fraud may be the work of the company's top managers: as losses pile up during the recession, some executives will resort to creating false earnings statements that inflate profits and make the company appear to comply with the bank loan agreement.

"A lender might call us in to investigate. Maybe the loan is collateralized with accounts receivable or inventory, and the bank wants us to make sure there are enough receivables or inventory to secure the borrowing," she said.

Experts said the most important defense against fraud is a "tone at the top" that sends the message that unethical behavior isn't tolerated.

"If I'm the owner of the company, and I tell everyone to put in an expense account with receipts for everything, and then I just go to the bookkeeper and say, 'I had an expense for $500 last month, cut me a check,' that sets a bad tone at the top, and the employees will try to slip things through," said **Darryl S. Neier**, who heads the forensic accounting and litigation group at **Sobel & Co.**, the Livingston CPA and consulting firm.

Forensic accounting is one of the fastest-growing niche areas for the accounting profession, said Neier, who joined Sobel in 2001 and has assembled a team of 13.

Segregation of financial duties is the key to preventing inside theft, and no company is too small to work this out, Neier said.

"I get this question all the time: 'I have a one-person accounting staff, so how can I have segregation of duties?' I tell business owners to have the company's bank statements sent to their home address, instead of the office, so you're the first person who looks at it," he said.

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