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Fraud Case Study: Travel and Expense Fraud

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Certain situations increase the likelihood of fraud, such as when a trusted employee is under financial pressure, feels he deserves greater recognition or more pay, and has the ability to prepare and obtain approval for reimbursement of any travel and expense submissions. The following three conditions reflect the elements of the fraud triangle:

- An unshareable need, such as financial pressures arising from a gambling or drug habit, crushing medical bills, or the habit of living beyond one's means
- The ability to rationalize the act of fraud and "make peace" with committing a crime
- The opportunity to commit the fraud by creating overstated expense reimbursement requests and the knowledge that the system of internal controls is sufficiently lax for such requests to be approved.

These conditions recently arose at a financial services information vendor, and the fraud scheme resulted in a material overstatement of expenses over a three-year period. A thorough and well-documented investigation allowed management to fire the miscreant, restate the financial results, and file amended tax returns.

The Player

The schemer, Pat (names changed for anonymity), was responsible for business development, which required frequent travel and entertaining clients and vendors. Pat lived in a huge loft apartment in New York's trendy SoHo district and was very fond of modern art and fine dining. The apartment, expensively furnished and professionally decorated, had been featured in design magazines. But Pat felt underpaid and jealous that the company's CEO (Jean), whom Pat had known for many years, earned much more money.

The company had offices in various financial capitals around the globe, with its executive offices in London (Jean's location) and its main operating office in New York (Pat's location). As the director of business development, Pat answered directly to Jean. The company's CFO, also based in London, was responsible for approving Pat's biweekly travel and expense reimbursement requests.

The Scheme

Pat developed a practice of keeping both the itemized meal receipt and the credit card receipt from restaurants and would submit both of them over the course of several months. To avoid detection, Pat would tear off the top of the itemized receipt that contained the restaurant name and address, and would obliterate the receipt's date by writing the purpose of the meal and names of the attendees over it. The final totals on the respective receipts would differ by the amount of the tip; however the food and drink total would be the same.

A private booking agency managed air travel, providing an itinerary and invoice (typically in the form of an electronic document) for each trip taken. In order to extract additional value from this process, Pat would create a Word document that replicated the itinerary and invoice, and would include fictitious travel arrangements at inflated prices.

The scheme was detected when the company's local controller noted a large fluctuation in the travel and entertainment expense category and notified management, which authorized an investigation.

Control Weaknesses

All of these excessive charges were made possible because Pat used a personal credit card, rather than the company's corporate card. In addition, there was no reconciliation between the air travel invoices submitted by Pat and any corroborating data from the booking agency. Furthermore, the approval of the reimbursement requests by the London office created an information vacuum between Pat, the CFO, and Jean. The officers in London had no idea of Pat's activities or travel.

The Investigation

In conducting the investigation, forensic accountants analyzed the amounts paid for all travel, as well as hotel and meal expenses. They noted amounts, date of submission, and any other information available. By analyzing the amounts of the meal receipts, they identified duplicate charges. Further analysis revealed that hotel bills had been redacted or otherwise altered to change the dates of stay and to delete the details of room-service charges. In addition, an e-discovery team made a forensic image of Pat's computer and discovered multiple document files of fictitious air travel invoices, as well as evidence of significant purchases of art, amounting to hundreds of thousands of dollars.

Based upon the procedures performed, the forensic accountants calculated that Pat had received almost $500,000 in excess reimbursements over a three-year period. It should be noted that Jean's salary was $175,000 great than Pat's. Over the three-year period, the additional tax-free earnings from the scheme brought Pat's total compensation to a level equivalent with Jean's. The company chose not to file criminal charges against Pat or to file an insurance claim because it was actively seeking to be acquired by a larger company and did not want to draw attention to the theft, the breakdown of internal controls, and the related management failure.

Based upon the findings of the forensic accountants, the controller restated the internal financial results of the company, reallocating the amounts embezzled from travel and entertainment expense to casualty loss. The tax treatment for this situation required filing amended returns to reduce the meals and entertainment item and to reflect the offsetting amount on Form 4684, Casualties and Thefts, Section B, Part II.

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