

The Challenges of Expense Account Fraud

INTRODUCTION

Expense fraud is one of the most pervasive types of fraud in organizations. According to the Association of Certified Fraud Examiners (ACFE), 13.8 percent of fraud schemes involve expenses. For many people expense reimbursement fraud is easier to rationalize. Someone who might never steal funds from a company may feel little guilt over padding his or her expense account or purchasing something small for personal use with business monies. The median loss for organizations that are victims of expense fraud is approximately \$30,000.

About 27 percent of expense reimbursement fraud comes from employees that hold executive or upper management positions. Because they are in higher positions and engage in many activities involving business, managers may feel less inclined to separate business expenses from personal expenses. Countless headlines have highlighted top officials who have treated company or government funds as their own personal piggy banks. Former agriculture commissioner Richie Farmer, for instance, was found guilty of using state funds to pay for shirts, laptops, and filing cabinets; using \$20,000 for a buy local initiative to sponsor a racing team owned by a relative; and pocketing extra gifts that were purchased with state funds for agriculture commissioners.

This lavish spending by top officials sets a tone at the top in which excessive spending and expense account padding is an acceptable practice. Employees are less likely to consider it unethical to falsify or exaggerate expenses if they observe top management doing it. Perhaps this is why expense fraud is four times more likely to occur in a company than corruption or financial statement fraud. Over time these false expenses add up. In one study, it was estimated that \$13.7 million was lost due to fraudulent transactions in a mere three months. It takes a company approximately two years to discover expense accounting fraud, which typically allows this fraud to go on a long time without detection.

This case begins by examining the Fraud Triangle and how its attributes of pressure, opportunity, and rationalization are used in accounting fraud. The case next provides examples of expense fraud, including the well-known scandals that occurred at Walmart and Hewlett-Packard (HP). It then categorizes common types of expense fraud that occur in organizations. Finally, it discusses controls that organizations can adopt to prevent this fraud or detect it early.

THE FRAUD TRIANGLE

What causes individuals to commit expense fraud? Sometimes the tendency to commit fraudulent behavior is considered more inherent to the person. For instance, we know that certain people are

more honest than others. Competitive types concerned with winning may be more inclined to commit unethical behavior to achieve their goals, particularly if they feel that the rules are unfair. However, many others believe that a mix of organizational factors contributes more strongly to an employee's tendency to commit fraud. The Fraud Triangle is a model that explains three common factors that are behind most fraudulent behavior: pressure, opportunity, and rationalization.

Consider the plight of the salesperson whose company will not reimburse her for tips. She might feel pressured to add the tips to her expense reports by padding taxi or restaurant receipts. This pressure increases when padding expenses is an established part of the company culture. For instance, if all other salespeople pad their expense reports, the salesperson might be pressured to do the same because if she does not she might cause management to wonder why her expense reports look so different from her colleagues'.

Opportunity occurs when there are weaknesses in internal controls. For instance, many companies do not have strong travel policies in place. Supervisors also have a tendency not to examine travel expense reimbursements carefully. This makes it easier for an employee to submit fictitious receipts, such as providing more than one reimbursement claim for the same transaction. When executives engage in lavish spending without much regard for separating personal and business use of funds, this also creates a strong precedent for subordinates to do the same. We discuss some examples of high-level expense fraud in the next section.

Finally, employees rationalize the unethical behavior to make it more acceptable for their consciences. Some common rationalizations for committing expense fraud is that the employee deserves the extra luxury or that everyone else in the company is doing it. A CEO or other high-level executive might argue that he or she is on the job constantly, making it difficult to take the time to differentiate between business and personal expenses. By rationalizing the bad behavior, employees not only make it easier for themselves to commit fraud but also to continue engaging in fraudulent behavior in the future.

EXAMPLES OF EXPENSE ACCOUNTING FRAUD

Expense accounting fraud can occur at any level of the company. However, it tends to occur with higher level employees because they are provided with more opportunity to use company resources. It is often necessary to give employees who go on business trips or purchase business supplies the authority to make transactions on behalf of the firm. As an example, many employees are issued company credit cards. A former senior marketing consultant from MetLife was found guilty of fabricating false invoices for \$200,000 that she spent on shopping and psychics using her company credit card. Although many fraudsters do not spend quite so much, the temptation to use company resources for personal gain can be great for employees who have access to these resources.

Sometimes the fraud goes all the way to the top. In fact, it is unusual for wide-scale expense fraud to occur in an organization without the notice or participation of top managers. Because top managers often have more freedom to use company funds for business expenditures, they often have more of an opportunity to commit acts of fraud such as fraudulent expense reimbursements. Two notable

cases of executive expense fraud that occurred at Fortune 500 firms include scandals at Walmart and HP.

In 2006 Thomas Coughlin, former vice chair of the Walmart board, was found guilty of wire-fraud and tax evasion. He disguised much of the fraud as expenses. Coughlin falsified expense reports so he could use company funds to pay for personal transactions, including hunting gear, truck upgrades, liquor, handmade alligator boots, and a \$2,590 dog enclosure. Coughlin admitted to using Walmart cash, reimbursements, and shopping cards improperly. It is estimated that he might have stolen half a million dollars from the firm through these methods. Because he was a top executive who had legitimate uses for company funds, it made the fraud harder to detect. Coughlin was finally caught after asking a Walmart employee to approve \$2,000 without any receipts to substantiate the sum. As a result, Coughlin was forced to resign, give up his retirement package, and serve 27 months of house arrest.

Mark Hurd was CEO of HP from 2005-2010. In 2010 he was forced to resign amidst revelations of an inappropriate relationship with a part-time employee. While an investigation determined that Hurd had not violated the company's sexual harassment policy (the woman had alleged sexual harassment), he had misused \$20,000 in company funds to pay for dates and hotel rooms with her. Expense reports were inaccurately filed to hide the relationship. Mark Hurd lost his job as CEO but was later hired as co-CEO of Oracle.

Both of these scandals had profoundly negative impacts on the companies involved. Walmart shares plummeted after the Coughlin scandal was disclosed. For HP billions of dollars in shareholder value was lost and several lawsuits were filed as a result. Additionally, the reputational costs that occur at these companies can be even more extensive and take longer to restore.

Expense accounting fraud is not only limited to for-profit firms, however. In academia, where professors are often issued reimbursements for travel and educational expenses, the opportunity to commit expense fraud is high. In some cases certain actions considered unethical by outsiders could be accepted as a part of the academic culture. Not only is there high opportunity to submit reimbursements for personal expenses, but it is not uncommon for professors to register for a conference held in an area where they would like to visit, sign in at the conference, and then not attend any sessions but instead take a vacation and submit the conference expenses for reimbursement. Although this might be acceptable among some faculty members, like executives professors found guilty of this type of fraud can be disciplined and possibly fired.

TYPES OF EXPENSE FRAUD

Many instances of expense fraud involve bogus expenses via company accounts and reimbursements for transactions that were not company-related business. Travel and entertainment (T&E) expense fraud is particularly prevalent; one survey found that 54 percent of employees admitted to misusing funds for this purpose, whether it involved airline upgrades, lavish dinners, or falsifying receipts. Double dipping, for instance, refers to an employee who gets paid twice for the same event or activity and pockets the difference. A good example would be if a

conference paid for the meals of a guest speaker, but the speaker still submitted an expense report. He would get reimbursed but then pocket the money since his expenses have already been paid for.

The following are some of the most common types of expense accounting fraud that occurs at organizations.

HOTEL AND MEALS

Fraudulent hotel or meal expenses are a common type of expense fraud. Common schemes include staying at an inexpensive hotel while claiming that you stayed at a more expensive hotel on your expense account; claiming that you stayed at a hotel when you did not; and asking for double receipts from restaurants and submitting both for reimbursement. Other types of fraud could include sending out large bundles of laundry to be dry cleaned although the business trip is only one night, or adding incidentals such as pay-per-view or massages even though company travel policies do not cover those. Employees are able to achieve this fraud with falsified receipts or by turning in double receipts if they know the supervisor does not pay much attention to expense reimbursements. The best way for organizations to avoid this type of fraud is by clearly communicating acceptable travel policies and holding employees accountable for them. For instance, one company fired an employee who placed a movie rental at a hotel on her expense report.

MILEAGE REIMBURSEMENTS

Mileage reimbursement fraud is easily committed if an employee uses a company car or their own car for personal use rather than a business purpose. Without a GPS employers have a hard time tracking where an employee has been. Although an employer can have a GPS installed in a company-owned car and check it, some believe this is too intrusive of employee privacy. Other ways of detecting potential fraud is by examining past mileage reimbursements and seeing if there are any clear and unexplained deviations.

GIFTS & ENTERTAINMENT

This occurs when the employee is authorized to purchase gifts or entertainment for a client but retains some for him- or herself. Many companies will allow for small gifts and entertainment to be provided to potential clients. However, there is often a limit to the cash value of the gifts and entertainment to avoid the possibility of bribery. Therefore, it may not seem that an employee can commit major fraud in this area. On the other hand, as the case with former Kentucky agriculture commissioner Richie Farmer demonstrates, this type of fraud can quickly add up. Contacting the client as a courtesy can be a good way to determine whether he or she received the intended gift.

TAXIS AND RENTALS

It is not uncommon for taxis to provide customers with blank receipts, especially if asked. Blank receipts are an easy way for employees to put down more for reimbursement than what they actually paid for and pocket the remainder. An employee may also upgrade to a luxury rental car

without authorization. Some ways to prevent these activities include using company-arranged rentals and/or establishing corporate accounts with certain taxi companies, as well as arranging for a direct billing process.

COMPANY CARD

The most frequent misuse of a company card or account is purchasing personal items and claiming them as legitimate business expenses. Some employees have used cards to get cash from ATMs and then spend the money on personal items. Another way to commit fraud in this area is when employees return or get refunded for an item they purchased for business purposes and receives a credit on the card. They might then use this credit balance to purchase personal items rather than returning it to the organization.

AIRLINE

Air travel expense fraud occurs when employees upgrade to first class despite company policy or cancel flights but still submit it on their expense reports. Another common way of committing air travel fraud is purchasing a coach class ticket with your credit card but submitting expense reports for a first-class ticket and pocketing the difference. Keeping careful track of flight dates and double-checking with the airline—including having it email the receipts—is a good way to prevent this type of fraud.

CONTROLS

Although it might be relatively easy to commit expense accounting fraud, organizations with proper controls in place can decrease this type of fraud significantly. Sometimes simply examining the receipts turned in for expenses can reveal suspicious activity, such as unusual spikes in expenses or alterations in writing.

Auditing expense reports randomly and looking for discrepancies is also a good practice companies should adopt. Many companies implement continuous control monitoring or data analytics software to detect possible fraud. Looking for red flags, such as comparing employee expenses for similar trips to see if one is vastly higher than the other, is highly beneficial.

However, the best way to address fraud is to prevent it in the first place. Organizations should develop clear codes of conduct regarding business and non-business expenses and what constitutes legitimate travel expenditures. Receipts should be itemized so that the supervisor can determine which items were purchased. Clear disciplinary procedures for expense fraud can also reduce the opportunity to commit these actions.

Clear policies regarding travel will also help employees understand what is or is not appropriate. For instance, without a policy on taking a client out to dinner, an employee might choose a highly expensive restaurant or go the other way and choose a cheap restaurant that will make the client feel slighted. Therefore, having clear policies regarding expenses is important not just for

preventing fraud but also for ensuring that employees know how to spend funds when on a trip or entertaining a client.

Organizations should also adopt different controls for different types of expense fraud. For instance, one way a company might try to avoid air travel expense fraud is by putting the ticket under the company's name or asking the agency to stamp the ticket as nonnegotiable, which would require the employee to get approval before changing it.

One of the most important control measures is to hold management and top officers accountable for adhering to expense guidelines. The importance of this control cannot be overstated. In one organization, a manager who exaggerated his expense reports set the tone that such conduct was acceptable. Employees assumed it was accepted practice to cheat on their expenses. The firm ended up suffering a \$150,000 fraud scandal. Management sets the tone at the top for the organization, and employees look toward their superiors as models for appropriate conduct. Anonymous hotlines should also be used as a way to detect concerns at both for-profit and non-profit organizations. Texas A&M, for example, has a risk, fraud, and misconduct hotline employees can use to report concerns.

CONCLUSION

Expense fraud may not seem serious compared to more commonly reported types of fraud such as embezzlement or theft of company funds. However, filing phony expense reports is a type of company theft, and employees should be encouraged to see it as such. It is crucial that all employees—including top managers such as the CEO—adhere to expense accounting procedures. As the cases of Walmart and HP demonstrate, top company officials can and do get disciplined for fraud. Their actions not only cost the firm in shareholder value but also sets a tone for other employees to view the submission of phony expense reports as appropriate.

Supervisors should have controls in place to detect fraud in general, as well as specific types of expense accounting fraud such as air travel or mileage reimbursement. Although it is often impossible to audit every employee's expense account in a large company, randomized auditing can help to spot problems. If organizations are able to set controls that can reduce the pressures, opportunities, and rationalizations for committing expense fraud, then they will significantly reduce expense fraud in their organizations, save money, and be able to use their resources more efficiently.

QUESTIONS

1. Why is tone at the top so important in deterring expense account fraud?
2. What are some common types of expense account fraud employees commit? Why might they not believe this is as serious as committing other types of organizational fraud?
3. Describe some actions that organizations can take to deter or cut back on expense account fraud.

Sources:

- Association of Certified Fraud Examiners, "Schemes Based on Perpetrator's Department," *Report to the Nations on Occupational Fraud and Abuse 2014 Global Fraud Survey*, <http://www.acfe.com/rttn-perpetrator-schemes.aspx> (accessed June 29, 2015).
- Jazz Aujla, "Expenses fraud: Nature, nurture or a bit of both?" *aCloud blog*, February 27, 2015, <http://www.accesscloud.com/acloud-blog/posts/2015/february/expenses-fraud-nature-nurture-or-a-bit-of-both/> (accessed June 29, 2015).
- Mark Breur, "6 Signs Your Employees Are Abusing Expense Reports," *Insperity*, December 3, 2014, <http://www.insperity.com/blog/6-signs-your-employees-are-abusing-expense-reports/> (accessed July 9, 2015).
- Henry Blodget, "Well, There's No Longer Any Mystery Why HP Fired Mark Hurd," *Business Insider*, December 30, 2011, <http://www.businessinsider.com/mark-hurd-jodie-fisher-hp-2011-12> (accessed June 29, 2015).
- Rich Brody and O.C. Ferrell, "Professor Rich Brody—Fraud Triangle," *YouTube*, December 14, 2012, <https://www.youtube.com/watch?t=51&v=SPR6UssAYus> (accessed June 29, 2015).
- Matthew L. Brown, "Former MetLife employee pleads guilty to fraud in phony drug expense scheme," *Boston Business Journal*, February 4, 2014, <http://www.bizjournals.com/boston/news/2014/02/04/metlife-banana-republic-victorias.html> (accessed June 29, 2015).
- Laurel Carney, "How to Prevent Per Diem and Expense Report Fraud," *Tallie Blog*, December 10, 2014, <https://blog.usetallie.com/prevent-per-diem-expense-report-fraud/> (accessed July 9, 2015).
- Certify, Inc., "Study Shows \$13.7 Million Lost in Expense Report Fraud," October 3, 2014, <https://www.certify.com/2014-10-03-Study-Shows-137-Million-Lost-in-Expense-Report-Fraud> (accessed June 29, 2015).
- Chris Farrell, "5 Simple Steps to Prevent Expense Fraud," *Entrepreneur*, October 21, 2014, <http://www.entrepreneur.com/article/238748> (accessed June 29, 2015).
- O.C. Ferrell, John Fraedrich, and Linda Ferrell, *Business Ethics: Ethical Decision Making and Cases*, 10th ed. (Mason, OH: South-Western Cengage Learning, 2015).
- Liz Galst, "A Little Extra on the Road," *The New York Times*, November 15, 2010, <http://www.nytimes.com/2010/11/16/business/16expenses.html> (accessed June 29, 2015).
- Craig L. Greene, "Expense Account and Travel Fraud," *McGovern & Greene LLP*, 2013, http://www.mcgovernandgreene.com/archives/archive_articles/Craig_Greene_Archives/expense_acct_fraud.html (accessed June 29, 2015).
- Abigail Grenfell, "Employee expense reimbursements: Legitimate or fraudulent?" *Minnesota Society of Certified Public Accountants*, February/March 2015, <http://www.mncpa.org/publications/footnote/2015-02/employee-expense-reimbursements-legitimate-or-fraudulent.aspx> (accessed June 29, 2015).
- Misty Norris-Carter, "Are Your Travel Expenses Monitored?" *ACFE*, September 2013, <http://www.acfe.com/fraud-examiner.aspx?id=4294979665> (accessed June 29, 2015).
- Dan Ramey, "Detecting Fraud: The Tone at the Top," *Intuit Accountants*, May 22, 2012, <http://blog.accountants.intuit.com/from-the-experts/the-tone-at-the-top/> (accessed June 29, 2015).
- Ashley Strickland, "Check 'em twice: Expense accounts get some travelers in trouble," *CNN*, December 8, 2011, <http://www.cnn.com/2011/12/05/travel/expense-account-business-travel/> (accessed June 29, 2015).
- UNM Daniels Fund Ethics Initiative, "The Ethical Challenges Facing Public Officials: The Case of Former Kentucky Agriculture Commissioner," <http://danielsethics.mgt.unm.edu/pdf/agriculture-commissioner.pdf> (accessed June 29, 2015).
- Bob Van Voris and Jennifer Boulden, "Wal-Mart Ex-Vice Chairman Coughlin Gets House Arrest (Update4)," *Bloomberg*, April 11, 20016, <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aLkzGkSrUrZl&refer=home> (accessed June 29, 2015).
- Yasmin Vazquez, "The Fraud Curve: White-Collar Crime in Higher Education," *ACFE*, <http://www.acfe.com/fraud-examiner.aspx?id=4294972114> (accessed June 29, 2015).
- Ben Worthen and Joann S. Lublin, "Mark Hurd Neglected to Follow H-P Code," *The Wall Street Journal*, August 8, 2010, <http://www.wsj.com/news/articles/SB10001424052748704268004575417800832885086?cb=logged0.18489948357455432> (accessed June 29, 2015).
- Candice Wierzbowski, "More than 50% of employees own up to committing T&E fraud," *CFO Daily News, November 5, 2013*, <http://www.cfodailynews.com/more-than-50-of-employees-own-up-to-committing-te-fraud/> (accessed June 29, 2015).