

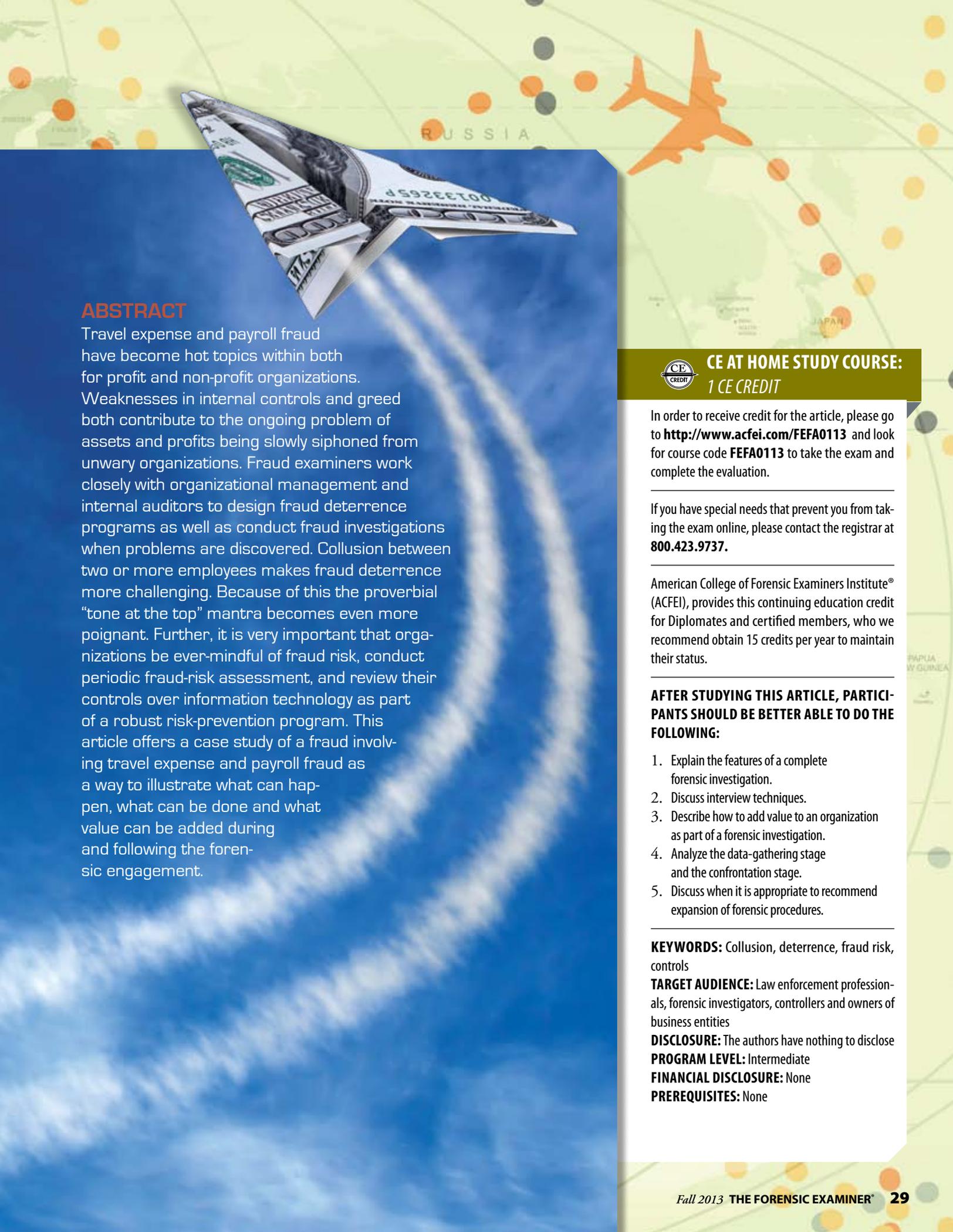


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# TRAVEL EXPENSE & PAYROLL FRAUD & CASE STUDY:

Inquiry, confrontation, admission,  
restitution, and internal controls

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## ABSTRACT

Travel expense and payroll fraud have become hot topics within both for profit and non-profit organizations. Weaknesses in internal controls and greed both contribute to the ongoing problem of assets and profits being slowly siphoned from unwary organizations. Fraud examiners work closely with organizational management and internal auditors to design fraud deterrence programs as well as conduct fraud investigations when problems are discovered. Collusion between two or more employees makes fraud deterrence more challenging. Because of this the proverbial “tone at the top” mantra becomes even more poignant. Further, it is very important that organizations be ever-mindful of fraud risk, conduct periodic fraud-risk assessment, and review their controls over information technology as part of a robust risk-prevention program. This article offers a case study of a fraud involving travel expense and payroll fraud as a way to illustrate what can happen, what can be done and what value can be added during and following the forensic engagement.



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#### AFTER STUDYING THIS ARTICLE, PARTICIPANTS SHOULD BE BETTER ABLE TO DO THE FOLLOWING:

1. Explain the features of a complete forensic investigation.
2. Discuss interview techniques.
3. Describe how to add value to an organization as part of a forensic investigation.
4. Analyze the data-gathering stage and the confrontation stage.
5. Discuss when it is appropriate to recommend expansion of forensic procedures.

**KEYWORDS:** Collusion, deterrence, fraud risk, controls

**TARGET AUDIENCE:** Law enforcement professionals, forensic investigators, controllers and owners of business entities

**DISCLOSURE:** The authors have nothing to disclose

**PROGRAM LEVEL:** Intermediate

**FINANCIAL DISCLOSURE:** None

**PREREQUISITES:** None

**O**n a warm summer day in early July 2011, a key member (“Ms. Smith”) of the executive team of X company sat in her office, preparing a request form for routine travel expense reimbursement, attaching documentation in support of the costs of the air-ticket portion of her planned trip, which she had purportedly booked recently and paid for using her personal credit card. The organization where Ms. Smith worked did not have a corporate travel account. Therefore, employees would use their own charge accounts and submit for reimbursement.

After signing the form, Ms. Smith walked to the office of the Chief Financial Officer (“CFO”) to ask for his approval of the requested reimbursement. The CFO, who knew Ms. Smith well and had worked with her at a previous company, probably engaged in social conversation. He must have quickly glanced at the documents, not bothering to inspect them or review the total cost of the trip given his developed trust in Ms. Smith’s credibility. The CFO initialed the form and gave it back to Ms. Smith, who then went to see Alex, the accounts payable clerk with whom she had also worked at the prior company. She wanted Alex to immediately process her travel-expense reimbursement request and approve the wire transfer of \$6,250 into her personal bank account. Alex was only too happy to assist her with what he must have considered a routine task. He was busy with other tasks and did not take the opportunity to review the details connected with the travel-expense reimbursement request. Alex immediately initiated the wire transfer, filed the documents into Ms. Smith’s folder for her trip, and then moved on to the rest of his busy day.



### **WHAT HAPPENED? THE FIRST SCHEME WAS DETECTED**

The documentation in the case comprised an airline travel itinerary for an international destination but did not include invoices for hotel accommodations and receipts for transportation and other incidental expenses because the trip had not yet taken place. The total requested reimbursement was \$6,250. Ms. Smith was pleased, but fraud has occurred. How and where did the breakdowns occur in preventive or detective controls?

Those involved did not follow company policy. As part of the findings of the investigation, the organization’s employee handbook requires that all travel be arranged through the organization’s travel agent and paid for by the organization directly. This requirement was outdated because the organization did not have a current contract with a travel agency.

### **THE INVESTIGATION CONTINUED**

In February 2012, forensic examiners Eric Kreuter and Sareena Sawhney (“the forensic team”) were invited to a meeting with one of the members of the Board of Directors of a multinational philanthropic organization to discuss a potential problem with Ms. Smith, one of the members of their executive team. During the meeting it was revealed that the Board had recently been informed through an anonymous letter that Ms. Smith had a previous criminal record for embezzlement—something she did not disclose on her employment application. The Board realized that it had an immediate and urgent obligation to better understand the background of Ms. Smith’s prior conviction. After discussion, they agreed to commission a forensic review of her current functions as they related to her ability to submit expense

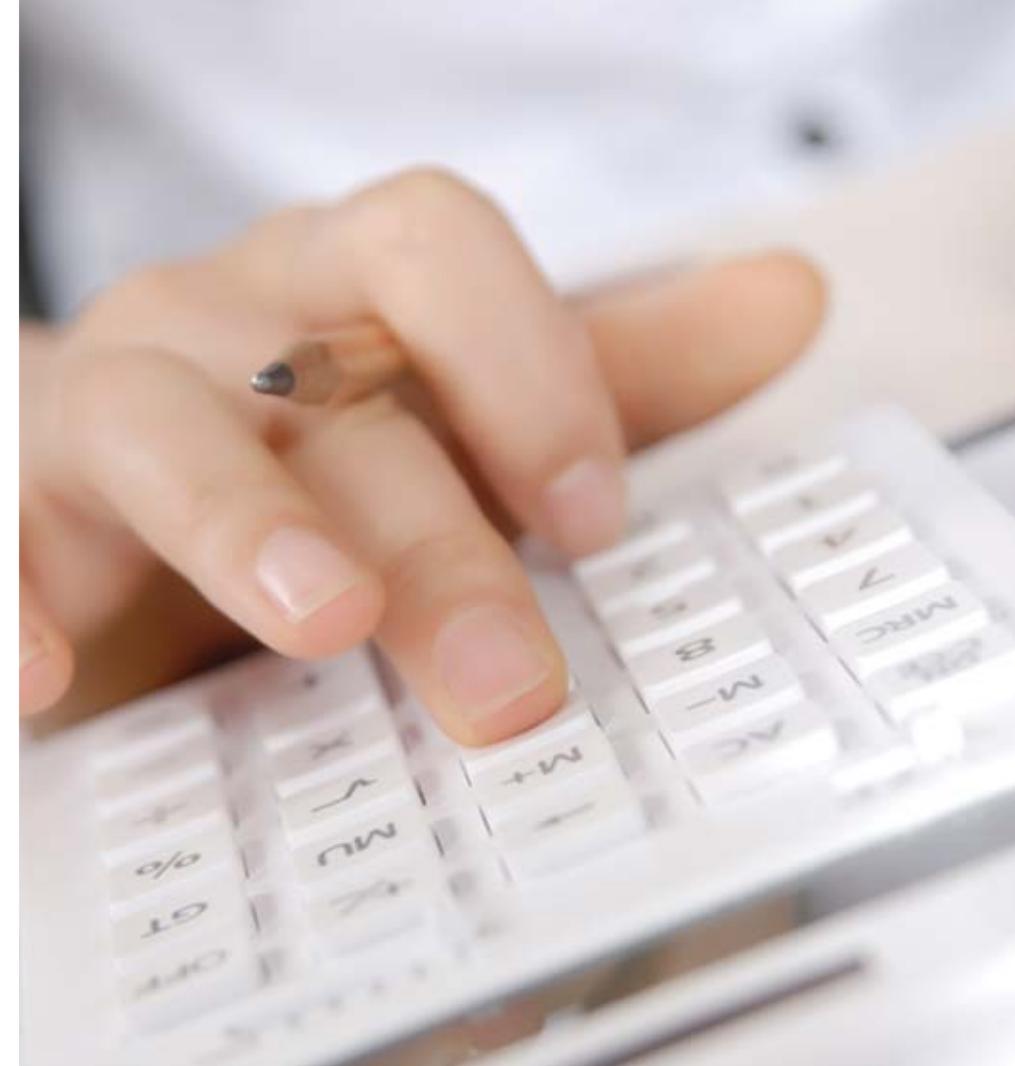
reports and receive reimbursement since her position requires frequent international travel. Kreuter and Sawhney issued a proposal for forensic services and negotiated an agreement. They designed the investigation to go forth discretely so Ms. Smith would not become aware of it. Planning for the covert investigation began; the forensic team requested documents of Ms. Smith’s past travel expenses and analyzed them. The forensic team found more than a dozen anomalies in just the first year of expense reports they reviewed. These anomalies included consistent violations of organizational policies requiring certain forms of documentation as well as duplication of reimbursement and missing proof of actual travel.

Kreuter and Sawhney provided a preliminary verbal report to the Board member who originally contacted them as well as to the organization’s outside legal counsel. In the report, Kreuter and Sawhney recommended that their forensic team conduct a formal interview with Ms. Smith for the purpose of presenting her with the anomalous data and eliciting her responses to the concerns raised in the preliminary phase of the forensic examination. The organization and outside counsel agreed to the interview process, which the forensic team would lead. The team arranged a meeting with the Senior Vice President of Human Resources (SVP HR) at the organization’s office. The SVP HR asked Ms. Smith to join him in the conference room, where she met Kreuter and Sawhney. Ms. Smith looked a bit surprised to find Kreuter and Sawhney in the room waiting for her. The interview was conducted, and Ms. Smith was provided with copies of some of the documents from her travel expense files, which formed the basis for the questions raised. Ms. Smith’s demeanor and

body language indicated signs of anxiety and evasiveness. For example, she lowered her head following some of the questions, and her face turned red when asked about some of the trips. She stated repeatedly that she needed to “review her records.” What was absent from her affect and attitude were any statements defending her integrity or outrage at being questioned over her routine travel-expense reports. Following the questioning, it was mutually agreed that Ms. Smith would bring additional documentation allegedly in support of her expenses to the office of Kreuter and Sawhney the next day for further review.

Kreuter and Sawhney continued to inspect the documents contained in Ms. Smith’s expense reports. There were questions concerning the authenticity of certain airline-generated documents as well as the cost of one particular travel itinerary that seemed unusually high. The forensic team contacted the airline and received information establishing that the actual trip was booked three months after the date of reimbursement and cost much less than Ms. Smith indicated on her travel-expense reimbursement form. Not only was the cost of a coach class ticket far less costly, but Ms. Smith actually upgraded her coach ticket to first class using accumulated air mileage. Kreuter also noticed that the e-mail confirmation from the airline was missing the year in the date reference. When questioned, the airline representative said that such confirmations of travel itineraries always contain the full date reference and that this information was generated automatically through their system; therefore, Kreuter suspected that the document may have been altered. It was further noted that the page containing the purported amount of the flights was on a separate page with no reference to the itinerary and only a reference to a charge on Ms. Smith’s American Express card. The potential that these documents were altered and/or matched together improperly was significantly increased because of the incomplete records. Kreuter also asked the airline representative about several other flight itineraries. The airline confirmed that two other expensive airline trips, for which Ms. Smith was reimbursed, were never booked and never took place. A pattern was starting to take shape. The second meeting would include confrontation with the newly discovered information.

Hours following the agreed appointment, Ms. Smith had not appeared for the second



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meeting and had not gone to the organization’s office that morning. Kreuter contacted outside counsel for the organization and the SVP HR to advise them of the situation and to suggest prudent preventive steps to be considered to protect the organization’s data security. A plan was devised. Ms. Smith did not show up for work. Later that day, Ms. Smith e-mailed additional documentation to Kreuter with a copy sent to the organization’s outside counsel and the SVP HR, concerning one of the trips in question. This documentation was supposedly meant to corroborate one of Ms. Smith’s trips as being taken for a few thousand dollars less than what she was reimbursed and that she owed the excess funds to the organization.





What is particularly interesting about this evidence is that Ms. Smith indicated that the original air ticket had been canceled by the CFO the day it was booked and then rebooked at a reduced fare at the end of September. It would later be proven that these statements were falsehoods. Ms. Smith said that she did receive excess reimbursement in an amount just over \$2,000. Ms. Smith then called Kreuter and first explained that there must have been a misunderstanding about the information she provided during the office visit, and then she brazenly asked if her new document “cleared up the concerns raised” over her travel expenses. Kreuter asked Ms. Smith if she repaid the excess reimbursement to which she responded, “I have yet to work that out with them.” When asked why she did not respond to the other questions raised in the first meeting, Ms. Smith said she thought the forensic team was primarily interested in that one trip. Her seemingly cool and collected demeanor at that point provided yet further evidence that Ms. Smith may have defrauded the organization.

Based on the information gathered to date and Ms. Smith’s responses, the organization made the decision to immediately terminate her employment. She was asked if she would continue to cooperate with the forensic team’s investigation. She readily agreed. Kreuter was asked to present the findings reached by him and Sawhney at the organization’s annual Board meeting.

Kreuter presented the findings of the forensic investigation and recommended expansion of the original parameters of the investigation to include a careful review of Ms. Smith’s travel-expense files for several additional years and also to include a review of the expense files of the former CFO based on several suspicious indications about his own travel expenses and possible complicity with Ms. Smith. The former CFO resigned in the fall of 2011. The Board was shocked at the reported findings and unanimously agreed to further forensic procedures. The expanded study commenced. Additional discoveries were made with respect to Ms. Smith and the CFO and also served to discover problems in the internal control sys-

tem and with the organization’s policies and procedures manual.

When Kreuter and Sawhney received the travel-expense files for prior years, they found no expense-reimbursement requests for 2009 for Ms. Smith, though there was an odd document—an accounts payable vendor payment summary for Ms. Smith labeled “consulting fees.” This was peculiar because Ms. Smith was considered to be an employee and not an independent contractor; therefore, why was she being paid through accounts payable? The forensic team made an additional inquiry, producing evidence that Ms. Smith’s status was altered in the organization’s records, showing her listed in the organization’s books and records as an independent contractor and no longer an employee, despite no records of her being terminated as an employee contained in her personnel files maintained in the Human Resources Department. The forensic team also discovered that Ms. Smith was included on the organization’s health and welfare benefits, as well as on the organization’s employee census for the retirement plan. Kreuter spoke with the SVP HR, who was startled at what they found. Kreuter contacted Ms. Smith and requested another meeting. Ms. Smith agreed, and this time she kept her appointment.

Kreuter interviewed Ms. Smith in the presence of a witness, Glenn Sacks, a seasoned professional accountant. Kreuter first asked Ms. Smith about the sudden switch in status from employee to independent contractor. She openly admitted to requesting this change and had stated that she had the express approval from the CFO. She explained that she wanted to change to this status as she had established her own consulting company and wanted to start consulting for other companies while continuing in her capacity with the current organization. She said this without flinching and without consideration for how absurd her story may have sounded.

Reverting back to discussing the travel-expense concerns, Ms. Smith did admit to receiving reimbursement for trips in excess of her cost, receiving reimbursement in advance of booking trips, and receiving reimbursement for trips that never took place; but she had not admitted to fraud at this point. When shown the airline travel confirmation and told that the airline recently provided information to Kreuter, refuting Ms. Smith’s story, she then confessed to altering the documents for the purpose of receiving additional funds she needed as her personal

debts were mounting (persons in such financial need may resort to embezzlement).

When questioned again about the change of status from employee to independent contractor, Ms. Smith also admitted to doing so for the purpose of eliminating any tax withholding, as she needed the additional funds for her personal financial obligations. She admitted she had continued to receive employee benefits as if she were still considered to be an employee and agreed that her actions should result in her being required to make restitution for funds received in excess of entitlement. She agreed to repay the excess travel reimbursements for 2011. Ms. Smith also understood that the other years' expense files were being examined and that the amount of employee benefits paid to her during the time she was listed as an independent contractor would be determined at a later date and communicated to her. When asked if she was aware of any other purposeful overpayments based on falsified documents, she said there weren't any.

### **IMPORTANCE OF THE Demeanor OF THE SUSPECT**

Especially during the initial part of the interview (prior to her confession), Sacks and Kreuter noted that Ms. Smith appeared to be quite nervous (her hands were shaking and she continued to drink from a near-empty water bottle after refusing more water). At the start of the interview, she indicated that she was sick but showed no outward signs of being sick at any time throughout the proceeding. She reacted with silence and covered her mouth several times during responses to questions that directly related to the incriminating evidence. She blushed several times during some tense moments of questioning and some silence between questions, answers, and follow-up questions. She cried quietly at one point toward the end of the interview and expressed her sorrow over what she had done, stating that she did not manage her personal finances well and that she needed to "get her life together."

As is evident from the above description of Ms. Smith's nonverbal actions, an interviewer must play close attention to the autonomic body language of the person being interviewed. Very often nonverbal communication can be more important than verbal communication in a conversation. The study of nonverbal behavior related to the interpretation of body language was founded by Mr. Ray Birdwhistell, who coined the

science of kinesics. Kinesiology—human kinetics—is the scientific study of human movement. Birdwhistell believed that words take a back seat to nonverbal communication. He estimated that nonverbal communication conveys 65 to 70 percent of the information in a conversational interaction (Harold and Tobin, 2012, p.1). Just based on Ms. Smith's body language, she appeared to be extremely agitated and uncomfortable with the now-open facts and then seemed to become overwhelmed by the likely impact on her life. Interestingly, Ms. Smith did not ask if the organization planned to press charges with the District Attorney.

As described above, Ms. Smith's nonverbal communication was entirely consistent with that of a guilty person. Typically a guilty person will not express outrage at being accused of committing fraud but instead will try to manipulate facts and place the blame on others. As described herein, Ms. Smith expressed no outrage at being questioned about her expense reimbursements and employee benefits. She did state that she was not alone in not adhering to organizational policy.

Kreuter reported the results of the second meeting to several members of the Board as well as the outside attorney for the organization and the SVP HR. The investigation continued, deepening into internal-control weaknesses that were exploited, making it possible for Ms. Smith to conceal her embezzlement and alteration of records for a multiple-year period.

### **ACCORDING TO SKALEK, GOLDEN, CLAYTON & PILL, 2011:**

"The allegations must be carefully sifted to establish those that are potentially genuine and to set priorities for investigation—that is, where the greatest potential problems are in regard to financial loss, physical danger to persons or assets, legal implications, and so on" (p. 144).

The tenor of the anonymous letter received by the organization suggests collusion:

Collusion with third parties or other employees of the victim company, occurs when such parties are aware of irregular transactions, but do nothing to prevent them or nothing to bring them to the attention of either their auditors or the counterparty's auditors (p. 429).

The Senior Vice President of Human Resources received a handwritten letter from an anonymous author indicating that three employees of the organization have been working as a team to steal from the organization. The three employees were referred to by their respective titles and included the individuals referred to in this article plus the Director of Human Resources, who reports to the Senior Vice President. This letter has created additional concerns, but also serves to highlight the importance of a more detailed investigation into the areas of payroll, expense reimbursement, check writing, and wire transfers.



one in an organization has some responsibility for internal control. A strong system of internal controls begins with a sound control environment. The control environment sets the tone of the organization often referred to as “tone at the top” and provides an atmosphere in which people carry out their duties (COSO Report, 1992). An exhibit attached to Statement of Auditing Standard 99 (AU 316), *Consideration of Fraud in a Financial Statement Audit*, provides examples of programs and controls that management can implement to prevent, deter, and detect fraud. It describes how it is the organization’s responsibility to create a culture of honesty and high ethics and to clearly communicate acceptable behavior and expectations of each employee. Part of creating an appropriate culture is to hire and promote appropriate employees and to have a consistent method of responding to incidents of alleged or suspected fraud. Employees are very aware of how situations are handled in the companies they work for. Fraudsters will notice and take advantage of any and all perceived weaknesses in the internal control system.

Management can play a key role in designing control activities to prevent or detect fraud. Finally, an entity should also have an appropriate oversight and monitoring function in place. It is important for all organizations, even those with the most robust control systems, to continue to monitor the effectiveness of controls in place. Monitoring activities can typically be carried out by internal auditors, members of management, and personnel responsible for governance, such as the board of directors. There can be no letup in this effort.

Internal controls systems are not static; they are constantly changing and adapting to changing conditions about perceived new fraud risks. When a problem arises, such as that depicted in this case study, there is an opportunity to evaluate and fine-tune the internal control system and institute top-down changes. A willingness to examine policies and procedures with a view toward tightening controls will reduce risk.

Despite management’s best efforts to establish and maintain an effective system of internal controls, the possibility remains that fraud can and will occur. It is very difficult to overcome collusion between people or management override of established controls. Employees also can make honest mistakes in judgment that can cause well-designed internal systems to fail.

**“ULTIMATELY, THE ORGANIZATION IS IN MUCH BETTER SHAPE NOW THAT THE PROBLEMS HAVE BEEN UNCOVERED AND EFFORTS UNDERTAKEN TO ELIMINATE AS MANY SHORTFALLS IN THE SYSTEM AS POSSIBLE.”**

The organization informed the forensic team that the CFO committed improprieties with respect to submission of excess travel expenses in a prior year for which the organization was reimbursed. Despite being caught doing so, the CFO was allowed to remain in his job. The investigation was extended to a review of travel-expense reimbursement of the former CFO where anomalies were uncovered, leading to the need to commence a process of inquiry with the CFO in order to fully understand if additional improprieties have occurred. Kreuter and Sacks interviewed the CFO, who appeared somewhat aloof and dismissive of any notion that anything he did was either purposeful or harmful to the organization. This part of the investigation determined that the CFO did, in fact, receive excess reimbursement for his own travel expenses. He agreed to make restitution to the organization but vocalized his desire for the investigation to be over so he could move on with his life.

The potential existed for a wider scheme, especially in an environment of collusive activity, and warranted the increased investigation. The inherent weaknesses found during the forensic investigation in the organization’s internal control system were addressed in a

formal report and presented to the Board of Directors. A newly hired CFO has been tasked with implementing new internal control procedures throughout the organization. Kreuter and Sawhney made a number of recommendations to the organization for increasing detective controls and to implement some preventive controls. While the information uncovered in the forensic investigation has been unnerving for the Board and the executive management, identification of shortcomings in the system of controls will undoubtedly lead to improvements in the system to prevent further defalcations. Ultimately, the organization is in much better shape now that the problems have been uncovered and efforts undertaken to eliminate as many shortfalls in the system as possible.

#### **IMPORTANCE OF AN INTERNAL CONTROL SYSTEM**

A strong internal control system is critical in the fight to prevent fraud in an organization. A strong internal control system helps management achieve its objectives related to the effectiveness and efficiency of its operations, the reliability of its financial reporting, and compliance with applicable laws and regulations. It is management’s responsibility to develop and implement a strong system of internal controls and to monitor activity throughout the year as the only surefire way to be satisfied that fraud, if not deterred, can at least be readily detected. However, every-

Recently in the news we read about Jeff Neely, a federal official with the General Services Administration who is being investigated for excess spending related to travel. “In the last year alone, Neely, a GSA regional commissioner, took five GSA-funded trips to Hawaii, Guam and Saipan—and that was after his bosses were warned by the GSA inspector general to curb his travel” (Shields, 2012).



Engaging an independent forensic examiner to investigate concerns of the type mentioned in this article will ensure a thorough handling of the concerns raised. Following the investigation, there is usually renewed energy on the part of management to tighten internal controls.

### CONCLUSIONS

There are many reasons why employees will commit fraud against their organizations. Such behavior is easier in poor internal-control environments. Employees can carry out expense-reimbursement schemes through various means. Examples include submitting fictitious expenses, double billing, and/or inflating actual business expenses. In this particular case, Ms. Smith created fictitious expenses by submitting itineraries for trips that she canceled. Other examples of fictitious expenses can include charging for items for personal reasons, i.e., a hotel expense for non-business purposes. Double billing can occur by submitting the same receipts more than once for a period of time. The best way to detect this is by analyzing individual expense reimbursements to the employee to see whether duplicate amounts appear. Lastly, examples of inflating business expenses can occur when an employee gets reimbursed for extra tips when the original tip may already be included by the restaurant or claiming expense reimbursement for meals shared with a spouse rather than a business partner.

Ms. Smith was terminated for cause and made full restitution for monies stolen from the organization, and was appreciative for being treated humanely during the investigation. The former CFO has agreed to repay the funds he received that were found to be either unauthorized or paid in duplication with other expense reimbursement. He never admitted to purposefully defrauding the organization. The organization has taken a number of steps toward improvement of its internal systems and has begun to recognize the events that have occurred as a learning experience. ■

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