



Minimizing Risk of Employee Fraud

Anna Husa

Alexander Melfi

Terry Reid



GARDINER ROBERTS

What is fraud?

- The use of deception to dishonestly make a personal gain for oneself and/or create a loss for another.





Different types of fraud:

Examples:

- Crimes by individuals against consumers, clients or others in business (ie. Misrepresentation of quality of goods)
- Crimes by businesses against investors, consumers (i.e. selling counterfeit goods as genuine ones)
- Crimes by individuals against government (i.e. tax evasion)
- **Employee fraud** against employer (i.e. payroll fraud, falsifying expenses, thefts of cash or other assets, false accounting)



GARDINER ROBERTS

How big a problem is employee fraud?

- According to the Certified General Accountants Association of Canada (CGA Canada), employee fraud is a \$3.2 billion problem in Canada





GARDINER ROBERTS

Common Types of Employee Fraud

Vendor Fraud – payments to external contractors represents one of the most serious opportunities for employees to engage in fraud. Examples of vendor fraud are:

- Ghost Vendors
- Take-Over Vendors
- Same-Name Vendors
- Associated Vendors

Payroll Fraud - another area very susceptible to employee fraud. Examples include:

- Over payment of hours
- Over payment of expense
- Payment to “ghost employees”

Fraud: Where does the risk arise?

What is the impetus for employees to commit fraud?

- **Motivation:** Greed or need
- **Opportunity:** Fraud is more likely in companies where there is a weak internal control system, poor security, little fear of exposure, etc.
- **Rationalization:** “Victim” is seen as being large enough to absorb the impact or fraudster feels like s/he mistreated and accordingly business “deserved” it



Factors why employees don't report unethical conduct:

- No corrective action (employees cynical that employer wouldn't do anything if employee came forward)
- No confidentiality of reports (fear that in order to report suspicion, identity revealed to everyone)
- Retaliation by supervisors or co-workers
- Uncertainty as to whom to contact



Employee Fraud: 3 Case Studies

i. Wide-scale “Ponzi” scheme

Investment Advisor carried out large scale “Ponzi” scheme.

- Convinced investors to invest in mortgages offering high rates of return.
- Properties were purchased with money misappropriated from other investors.
- Money obtained from new investors was used, in part to pay “returns” to prior investors to avoid fraud being discovered
- Millions of dollars were misappropriated



ii. Single employee mortgage fraud

- Employee of bank worked in Personal Loans Dept.
- Opened line of credit using fictitious names and social insurance numbers of former clients
- LOC purported to be guaranteed by mortgage on residential property (turned out to be Bank branch)
- Over course of 2 years, LOC increased on several occasions. Loss of hundreds of thousands of dollars



iii. Small business misappropriation

- Business run by 2 friends
- Both had signing authority
- One partner left jurisdiction; left friend in charge
- When returned, reviewed books/records
- Discovered number of cheques that did not have supporting documentation/receipts
- Total loss was several hundred thousand dollars



GARDINER ROBERTS

Primary legal issues re: fraudulent employees:

1. When do you have cause to dismiss an employee?
2. What can you do to recover misappropriated assets?





- Employees have a duty to act in good faith
 - Where an employee has breached that duty, conduct can be basis for dismissal for “cause”
 - “Cause” is a legal term; threshold is high
 - Not all dishonesty gives rise to dismissal for cause
- McKinley v. BC Tel* [2001] 2 S.C.R. 161 (SCC)



GARDINER ROBERTS

Assuming dismissal of employee has been dealt with, focus turns to recovery:

What, if anything, can you get back?





Legal tools to assist in civil fraud cases:

1) *Norwich* order:

- Pre-action discovery
- Purpose: ensure that person who has been wronged will not be prevented from obtaining legitimate redress for wrong
- Fundamental principal: Third party against whom order is sought has an equitable duty to assist applicant in pursuing its rights
- Can be used to:
 - i) identify wrongdoers
 - ii) find and preserve evidence
 - iii) trace and preserve assets



2) *Anton Piller orders*:

- effectively a civil search warrant
- Granted by the court where there is a risk that evidence would be concealed or destroyed by the defendant
- Order allows plaintiff to attend at the defendant's location (accompanied by an officer of the court called an Independent Supervising Lawyer) without warning and to demand access to, search for and seize evidence.
- A defendant may face contempt proceedings if it refuses entry or fails to assist with the search.



3) *Mareva injunction*:

- “Freezing” order;
- Object is to prevent assets from being dissipated or concealed within the domestic jurisdiction or to prevent their disappearance outside the jurisdiction.
- As with Anton Piller order, *Mareva* injunction initially sought *ex-parte* (without notice to alleged fraudster)
- Valid for 10 days unless otherwise extended



4) *Certificate of pending litigation:*

- Used when interest in land is in question (ex. Misappropriated funds used to buy property)
- Purpose: give notice to anyone dealing with land of plaintiff's claim
- Until vacated, prevents dealing with land while proceeding is pending



GARDINER ROBERTS

Consider potential recovery from third parties.
Can you claim against anyone other than the
fraudster?



GARDINER ROBERTS

Legal remedies are expensive.

Often, assets are either depleted or virtually depleted, leading to minimum recovery.





GARDINER ROBERTS

What can be done to minimize risk of employee fraud?

Fraud: The importance of ‘tips’

- Occupational/employee fraud is more likely to be detected by tip than any other method
- Majority of “tips” come from other employees of the organization

(Association of Certified Fraud Examiners)





GARDINER ROBERTS

Fraud: Reducing the Opportunity

The opportunity to commit fraud refers to the workplace circumstances that make it possible for fraud to be committed.

The risk of employees committing fraud because they are able to can be mitigated and controlled by the use of effective **internal controls and procedures.**



Fraud: Reducing the Opportunity

Effective policies to address the opportunity for vendor fraud include:

- **Segregated Duties-** Establish procedures that apply checks and balances for approving purchase orders, authorizing payments and issuing cheques. More than one employee should be involved in any activity involving the disbursement of funds.
- **Internal Audits-** Internal audits of account payable to track suspicious patterns
- **External Audits** - periodic audits of a vendor's records and documentation that supports billings to the company, and ensures they are abiding by the applicable agreement you have with them.
- **Due Diligence** – verify the existence of vendors, their contact details and management, and ensure vendors have their own policies in place to combat fraud



Fraud: Reducing the Opportunity

Effective policies to address the opportunity for payroll fraud include:

- Have direct line managers review and certify payroll reports
- Internal audits for red flags
- Automated systems for tracking employees entering/exiting workplace
- Require timely and complete submission of expense reports and accept only original documentation
- Monitor changes to employee payroll information (addresses, account information, etc.) and cross reference payroll names against company telephone lists, rosters



GARDINER ROBERTS

Fraud: Reducing the Intention

The intention to commit fraud refers to the mindset of employees willing to commit fraud.

The risk of employees committing fraud because they motivated to do so can be mitigated and controlled by the use of effective **training and the creation of a culture of integrity.**



Fraud: Reducing the Intention

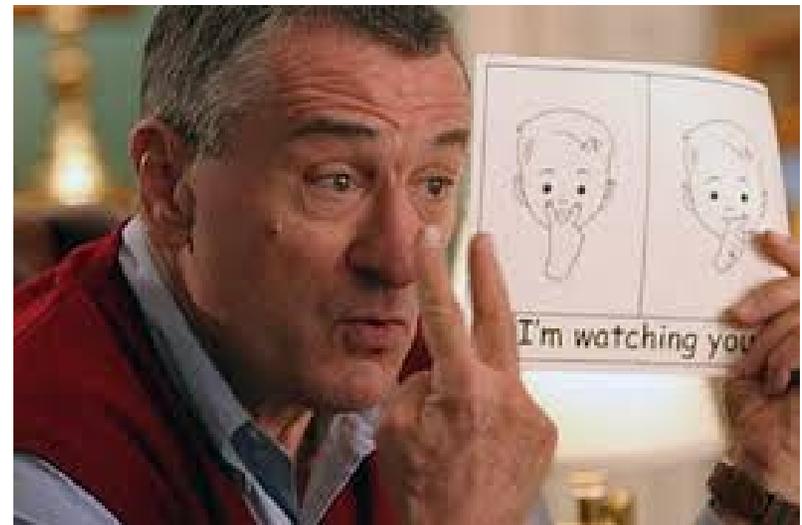
Establishing a culture of fraud prevention is essential to any successful policy, this can be accomplished by:

- Hiring ethical people.
- Developing and communicating high ethical standards.
- Ensuring that code of conduct training and manuals include practical guidance for employees in your specific industry.
- Ensure 'buy-in' from senior leadership on down
- Developing a culture that supports, and expects, the reporting of ethical lapses, including the implementation of a whistleblower policy.
- Taking ethical and consistent action when violations occur

The objectives of company policies should be to:

- Improve oversight of those employees who would otherwise be provided an *opportunity* to commit a fraud
- Create a perception of detection – the idea amongst employees that they *will* be caught if they attempt to conduct a fraud
- Enforce a zero tolerance goal from the top on down
- Foster a positive working environment amongst employees

Fraud: Policy Objectives



Code of Conduct

Code of Conduct:

- Sets out responsibilities/proper practices for an employee with respect to such items as:
 - dealing with personal financial difficulties
 - accepting gifts from customers
 - dealing with company assets
 - defining “reasonable” company expenses
 - conflict of interest scenarios
 - disclosing outside business interests



References

- Does Canada Have a Problem with Occupational Fraud? Report by the Certified General Accountants Association of Canada: http://www.cga-canada.org/en-ca/ResearchReports/ca_rep_2011-12_fraud.pdf
- *McKinley v. BC Tel* [2001] 2 S.C.R. 161 (SCC)
- *Norwich Orders: Norwich Pharmacal Co. v. Customs and Excise Commissioners*, [1974] A.C. 133, [1973] 2 All E.R. 943 (H.L.)
- *Anton Piller Orders: Anton Piller K.G. v. Manufacturing Process Ltd.*, [1976] Ch. 55, [1976] 1 All E.R. 779 (C.A.)
- *Mareva Injunctions: Chitel v. Rothbart* (1982), [1982 CanLII 1956 \(ON CA\)](#), 39 O.R. (2d) 513 (C.A.), *United States of America v. Yemec* (2005), [2005 CanLII 8709 \(ON SCDC\)](#), 75 O.R. (3d) 52 (C.A.), *O2 Electronics Inc. v. Sualim*, 2014 ONSC 5050 (CanLII)
- Certificates of Pending Litigation: *Rules of Civil Procedure*, R.R.O 1990, Reg. 194, Rule 42.02, *Courts of Justice Act*, R.S.O. 1990, c. C.43, s. 103, *Perruzza v. Spatone*, 2010 ONSC 841 (CanLII),
- LSUC Rules of Professional Conduct:
<http://www.lsuc.on.ca/WorkArea/DownloadAsset.aspx?id=2147502382>