

Lifestyles Can Be Red Flags: Know the Warning Signs of Fraud

By Diane C.O. Gilson, CPA, CIA, President, Info Plus⁽⁺⁾ AccountingSM PC

Re-printed from Nation's Building News, March 1, 2004

The fourth in a series about preventing fraud from affecting your business.

When professionals investigate a fraud after the fact, they often discover that company owners or management overlooked or ignored obvious warning signs. Because fraud often is committed by trusted employees whom owners know well, it pays to look out for employee lifestyle issues that may be “red flags” indicating a fraud risk.

Lifestyles of the Rich and Lavish

Some embezzlers are secretive. They don't want to get caught, so they stash stolen funds away and are very careful with their spending.

But other perpetrators can't resist spending fraudulently gained money. Typically, over time, they want to use it, enjoy it, share it and show off. They may purchase clothes, cars, property or gifts for others. They may send their children to better schools or entertain lavishly. Think of this group as the “aspiring” embezzlers.

How do they explain these new spending habits? They might volunteer something like:

- “My husband/wife just got a great promotion.”
- “I have a few little investments that have been doing really, really well.”
- “Great Aunt Evelyn passed away and I was totally surprised — she left us quite a nice little nest egg.”
- “I finally decided to get rid of some property that's been in the family for years.”

In many cases of fraud, perpetrators openly live beyond their means.

Recommendation: Be alert to changes in employee spending patterns and lifestyles. In our society it's considered rude, and even illegal in some instances, to pry into someone's personal financial affairs. But you can listen closely to explanations about extra funds and subtly try to find ways to verify that money is coming from somewhere other than your company. For example, you can look up property sales, since they're public records, or casually ask for the name of the investment that's done so well and then investigate its performance. Don't be afraid to dig a little.

Problem Lifestyles Demand Additional Funding

On the other end of the scale are people we might consider “lifestyle problem” embezzlers. Although it can be personally hard to accept, please remember that addictions are pervasive at all levels of our society. Whether you realize it or not, you probably know several people who are experiencing active addiction or are in recovery.

Someone who is dependent on drugs, alcohol, gambling or other addictions typically experiences a slowly tightening noose of financial pressures. Underlying desperation can fuel monetary needs. Like drowning people who drag others down with them, people suffering from active addictions may do serious financial and emotional damage to you if they decide to “borrow” some of your funds to ease their financial dilemma.

Employees with addiction problems can be tough to spot, especially if you aren’t attuned to the nature and warning signs of addictions. Many people with addictions can function at fairly high or normal levels of behavior during work hours, but over time you may notice puzzling patterns of:

- Absenteeism
- Regular ill health or “shaky” appearance
- Easily making and breaking promises and commitments
- A series of creative “explanations” regarding those situations
- A high level of self-absorption
- Inconsistent or illogical behavior
- Forgetfulness or memory loss
- Family problems
- Evidence of deceit (small or large)

Recommendation: If you suspect that you have an employee with these types of problems, immediately seek professional substance-abuse counseling assistance. Addiction problems are very serious and even life-threatening situations. By getting professional guidance, you may not only protect yourself; you may save your employee’s life and make a huge difference in the quality of life for many others (including the employee’s children) in that person’s life.

After you have obtained professional assistance for yourself and the employee, you may decide to keep the person in his or her job at your company. But please err on the side of caution regarding access to your monetary assets. If the employee opts for treatment and standard long-term recovery processes, you can choose to restore financial responsibilities later when professional guidance and common sense indicate it’s safe to do so.

Other Financial Pressures

Nearly everyone faces a variety of common financial pressures at some time. For many reasons, some beyond their control, employees can find themselves in financially stressful situations due to:

- Medical bills
- Family responsibilities
- A spouse losing a job
- Divorce
- Debt requirements (e.g., credit cards, car payments, mortgages)
- Maintaining a current lifestyle
- Car repairs

The old problem of too much month left at the end of the money is common. Obviously, not everyone who faces these pressures commits fraud, but the higher the stress level, the more distracted and desperate an employee can become. That's when your assets look particularly attractive.

Recommendation: Although you shouldn't take on the role of parent or financial rescuer, if you become aware that an employee is facing these kinds of pressures, you can help guide him or her towards a reputable credit or financial counseling agency. These agencies can often help financially troubled families make special arrangements with creditors and can help them take steps to restore their financial footing. You'll end up with an employee who has higher self-esteem and is less stressed, more productive and less tempted to commit fraud. And you will have truly helped your employee and his or her family regain their pride and self-reliance.