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The Reasons Fraud Spikes in a Recession

By Adam Smith / London

As sure as growth slides and employment tumbles, so cases of fraud rise during recessions. This time is no different. According to a report out today from The Network, a U.S. firm that runs compliance and corporate governance hotlines for about half of the Fortune 500, fraud-related calls amounted to 21% of all reports in the first quarter of this year, up from 14% in the same period in 2007. While reports of problems such as harassment, discrimination or health and safety transgressions saw "no appreciable increase", according to Luis Ramos, The Network's CEO, the number of whistleblowers reporting fraud, theft, or the misuse of company assets, he says, is "going up dramatically."

It's too early to gauge the extent of corporate fraud triggered by the recent gloom, but with credit scarce and jobs precarious, there's little doubt we're in a boom time for scams. A majority of members of the U.S. Association of Certified Fraud Examiners polled in February and March said they'd seen the number of company fraud cases climb in the previous 12 months, with the bulk of those experts attributing the rise to heavier financial pressure. ([See pictures of the global financial crisis.](#))

One of the reasons for that is that middle management, often a company's eyes and ears for detecting illicit activity, regularly bears the brunt of redundancies during a slowdown. "When that layer's removed, you've eroded your internal processes which are there to control fraud or misconduct," says Hitesh Patel, fraud investigation partner at KPMG in London. A key factor in fraud cases during Britain's last recession in the early 1990s, it amounts to "a change to business strategy, without a change to the business process," says Patel.

The slump may also help fraudsters rationalize their behavior. According to a survey published in February by British insurer RSA, 3% of adult Britons said hard economic times made committing insurance fraud more acceptable. We're seeing that already: the number of fraudulent claims rose 17% in the U.K. last year, with commercial claims accounting for a third of their value. ([See pictures of the crisis in London.](#))

But there's also another reason for the surge in cases of deceit. Far from simply fuelling fraud, there's nothing like a nasty bout of recession to flush swindlers out. By digging into their own operations amid the financial squeeze, firms are also unearthing historical deception. In 2008, U.K. courts tried individuals for the fraudulent loss of some \$450 million at the public and private organizations affected, according to KPMG, three times the amount in 2007. While some of that increase can be put down to wrongdoing prompted by the financial crisis, ongoing fraud uncovered as a result of the recession also played its part. "Companies are restructuring, revising their strategies, trying to preserve their interest, their cash, their

asset position," says Patel. "And because of looking at their businesses, they're starting to find more fraud." So too are company liquidators. With insolvencies among U.K. companies rising amid the downturn, disqualification proceedings against the firms' directors for fraud or theft rose 72% in the year to April, according to figures compiled by London law firm Wedlake Bell.

And as the recession tightens, employees nervous about their own positions have found themselves blowing the whistle on others. Helping drive up fraud-related calls to The Network, "employees are saying, 'Hey, I'm not going to look the other way', because if my company can't make its earnings, or can't safeguard its assets, then my job might be lost," says Ramos. With analysts forecasting plenty more fraud as a result of the global slowdown, whistleblowers may have their work cut out.

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