TO STEAL FROM STEEL, PART 2
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Subsequent to my MBA concentrating in corporate finance, I've spent my career in the international business field, including several years living and working overseas in what we shall call "distressed business environments". I learned years ago that in the former Communist Bloc, the employees' favorite slogan was "If you're not stealing from the State, you're stealing from your family." Theft from the company was endemic. Unfortunately, as recent Wall Street scandals attest, such behavior is not confined to the former Communist Bloc.

Let's take a look at some of the most common schemes and scams that greedy employees use to tunnel cash out of the steel mill and into their own private pockets. For the sake of this article, let us call these *Operating Schemes*. I will not address *Accounting Schemes* that are used to inflate earnings of public companies and use public money to enrich individual corporate executives, made famous recently by Enron and WorldCom (these are known in layman's terms as "cooking the books").

Operating schemes work wherever cash flows in to or out of the company. They are difficult for the company's own accounting department to catch, even during audit, since the perpetrators of the schemes are skilled at deception.

Accountants and auditors take the preponderance of their information from documents, and there must be an element of trust that these documents accurately represent reality. For example, when a vendor delivers a shipment of material to the mill and sends an invoice to Accounts Payable, Accounts Payable will authorize payment when the receiving document from Shipping and Receiving matches up to the invoice. The Accounts Payable clerk is seldom physically present when goods are received and can seldom personally vouch for a specific receipt through first hand knowledge (especially in large mills with thousands of transactions per week). There is an element of trust within the company that the Shipping and Receiving clerk has accurately documented reality (i.e., that 100 tons of scrap were actually received and checked into inventory).

The element of trust that allows companies to operate flexibly also opens them up to deception and fraud. Operating schemes fall into two general categories, since there are only two fundamental sides to cash flow in any company:

- *Cash In*
- *Cash Out*

CASH IN - The first category of operating scheme is on the Cash In side, where cash that should rightfully come in to the company is diverted to an employee instead. This is the "sell" or customer side scheme, and a company employee must be in cahoots with the customer. In the most common sell side scheme, goods from the mill are sold to a "preferred customer" at below the fair market price. Of course, the customer then turns around and immediately re-sells the goods at the fair market price…which the mill could have done itself in the first place. The salesman's excuse is that he could not get the business any other way, and the middleman had some special connection to the end customer. In reality, the difference is split between the middleman and the company's salesman, usually through a cash payment or a deposit to an offshore bank account. Sell side scams are common in export sales. In my consulting career, I have seen mills leave as much as 40% on the table when selling basic semi-finished goods to an export company instead of direct to the international end user. A hefty "commission" by any standards. Be on the lookout for any sales that can only be made through special connections. Shadowy Export Management Companies are often the culprit.

CASH OUT - The second category of operating scheme is on the Cash Out side, the buy or vendor side, where the company's cash is used to overpay a "preferred vendor". Invoice amount is a simple calculation of price multiplied by quantity. Cash can be tunneled out to the "preferred vendor" either through paying inflated prices or receiving less than the stated quantity of goods. In extreme cases, invoices are paid for materials that were never received. The vendor then splits the difference with the scheming company employee, again either through cash payments or transfers to an offshore bank account. Be suspicious of any manager vacationing in Cyprus…

In the steel business, I have seen payments made to a scrap vendor for delivery of rail cars loaded with rocks, with a bit of scrap laid on top. The scale ticket showed (what appeared to be) the proper weight received, the Accounts Payable clerk then paid the vendor for a full carload of scrap; a hundred dollar bill caused the receiving clerk to look the other way just long enough for the purchasing manager to pocket several thousand dollars.

My favorite scrap scam happened at a large European mill. The mill had a large obsolete facility, but management was not tearing down the old mill and using the scrap, for unknown reasons. One day, when leaving the facility, we passed a private scrap collection yard 100 yards from the back gate of the old mill. The old mill was being unofficially cut down piece by piece at night, trucked out the back gate, and sold for cash at the scrap yard - who then re-sold it to the mill the next morning!

A common element of operating schemes is that they take appear to be independent market transactions, whereas they are, in reality, related party transactions. The buyer or seller are always somehow related to the corporate employee who is defrauding the company. The executive is often very well compensated to begin with. But there are no limits on greed.

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