

Is someone picking your pocket?



Mary was a model employee. Her co-workers loved her. To her supervisors, she was an ideal employee. Always one of the first to arrive and the last to leave. They could always count on her to put in extra hours when there was pressing work that had to get done. She did everything for others without asking for anything in return. She was selfless....or was she?

You see, everyone thought they knew Mary, but they really didn't know her outside of work. They didn't know that Mary's husband Bill was a gambler. Unfortunately, Bill wasn't very good at it and they were heavily in debt. To make matters worse, Bill lost his job. With the extra time on his hands, the gambling got worse. Mary feared they would lose everything and, with no where else to go, she felt she had no choice. She began to steal from her company.

Mary was the payroll supervisor. No one knew more about running payroll than Mary. She liked it that way. First, she began supplementing her own pay in minor amounts - no one noticed. Then, she decided to put her husband on the payroll - he had a different last name.

Mary eventually retired and got her twenty year pin at the annual banquet. Bill could have gotten a five year pin, but he didn't show up at the banquet. He was at the track.

The above sounds far fetched but it is more common than you think. Employee fraud is growing and it costs U.S. businesses billions of dollars annually.

Who pays for it? If they can, businesses pass it on to their customers. If they can't, which is many times the case with small businesses in competitive markets, the owner pays.

Embezzlers steal over \$400 billion annually, with an average of \$127,500 per embezzler.

Could it be happening to you?

Research indicates that 30% of all business failures are caused by white collar crime.

These staggering figures mean that you need to be on the lookout for fraud. You must be pro-active to protect your business. A number of common fraud schemes are listed below:

Fraud Schemes:

Lapping – This involves the manipulation of accounts receivable to steal cash.

Shell Company – An employee sets up a shell company (often with a fictitious name) and bills the employer for goods or services it does not receive.

Pass-Through Scheme – A shell company (owned by the employee) purchases goods and resells them to the employer at a marked-up price.

Pay & Return – The employee purposely over-pays a vendor. When the vendor returns the over-payment, the employee embezzles the refund.

Personal-Purchase Schemes – The employee orders personal merchandise and charges it to the company.

“Voiding” the actual check - The employee writes a check to the vendor (i.e., \$7,000), but enters the invoice and payment for more (\$10,000). Using the next check, he writes himself a check for \$3,000 and enters a void. When the bank statement arrives he destroys the two checks and forces the reconciliation.

Kickbacks – The vendor gives the manager money in return for awarding a contract to the vendor. The accounts payable clerk writes an inflated check to the vendor (a friend) and they split the overpayment.

You may wonder how these individuals sleep at night. Common rationalizations for fraud include: “They owe it to me.” and “I’m only borrowing it and will pay it back.”

Fraud prone organizations generally have characteristics that include:

- Lack of segregation of duties.
- Weak or loosely enforced internal controls.
- The primary corporate objective is profit instead of quality and good client service.
- Complaints from customers, vendors and employees are ignored.
- Employee morale and company loyalty are poor.
- Lack of monitoring and oversight.
- Tremendous employee turnover.

Perpetrators are often employees who are dissatisfied with their job or living beyond their means. They may have compulsive behaviors such as drugs, alcohol or gambling.

Perpetrators rarely take a vacation, because that would allow access to their closely controlled system. Their ego is most likely directed toward self-interests and material gain and they might see “beating the system” as an intellectual challenge.

You need to be on the lookout for signs indicating that you are a victim of fraud. Watch for circumstances such as:

- Continual cash flow shortage and budget overruns.
- Increasing accounts payable and receivable balances.
- Transactions that lack documentation or normal approval.
- Customer complaints about delivery of service and recording of payments.
- A significant number of year-end adjusting journal entries.
- Poor accounting records.

How can you protect yourself?

Your best defense against fraud is to put strong internal controls into place. Have a segregation of duties or compensating controls when applicable. You, as the Owner, should monitor the monthly financial statements and review budget overruns, and sign checks. Some additional thoughts:

- Review all invoices before signing checks.
- Require employees to take vacations.
- Process payments only from original invoices.
- Don’t sign blank checks.
- Assign passwords to limit access to company systems.
- Instruct the bank to send statements directly to you. If there is misappropriation of cash it has to run through the bank statement.
- Watch for unusual behavior.
- Have your CPA review your internal control structure.
- If you take cash payments, make certain that numbered receipts are used and reconciled to your daily deposit. You should keep cash on hand in a locked safe box.

There are a multitude of control procedures to implement. Knowing that a person is checking your work is a big step in deterring theft. Emphasize that there are procedures and policies in place to catch dishonesty. Consider implementing an anonymous fraud hot line to report improper/suspicious activities.

When hiring, make certain that you check references and conduct criminal background checks. When an employee leaves be sure to get keys back and change security codes.

Two out of three fraud schemes run more than one year before detection. Only three percent of schemes are caught in the first month.

Who detects the fraud?

A tip from another employee is the signal 26% of the time (fraud hot line). It is discovered by accident 19% of the time. Nineteen percent of the time it is discovered by an internal audit. Internal controls reveal a problem 15% of the time. An external audit reveals a problem with fraud 12% of the time and a tip from a customer is the remaining 9% in fraud detection.

Opportunities that allow fraud to be committed include lack of disciplinary action. By merely dismissing employees, a signal is sent to others in the company that fraud perpetrators will not suffer significant consequences for their actions.

What are you doing to protect yourself?

Fraud is in your own backyard. It's critical to put internal controls into place and be on the constant lookout for fraud.

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