



How to Deter Employee Fraud and Protect Your Company

by Howard Klein, CPA, CFE, CIRA, CVA

Employee theft can occur in many ways: ghost employees on payroll; inflated expense reports; fictitious vendors; skimming cash; rigged bidding processes; vendor kickbacks; lapping of receivables (a scheme that misapplies cash receipts to customer accounts to conceal embezzled funds); misuse of company credit cards for personal use; and so on. The first step in discouraging employee theft is establishing a proper “tone at the top” in regard to ethical behavior. Next, consider implementing the following proactive steps to deter employee theft at your company before it becomes a problem:

Segregation of Duties – Incompatible job assignments (i.e., preventing one person from having both access to cash and the *responsibility* for reconciling the bank statement) could encourage employees to help themselves to the company’s cash. Structure job assignments to minimize opportunities to embezzle funds. Establish processes that require critical steps to be approved by a second individual.

Mandatory Vacation – Make it mandatory for each employee to take at least one week of vacation annually. This will require another employee to fill that role for a short period, which will create an opportunity to observe any irregularities that the embezzler was attempting to cover up.

Bank Statements – Small business owners should have corporate bank statements and copies of checks mailed to their personal residence. A quick review could uncover irregularities. At a minimum, employees with access to the company’s bank accounts should be given the impression that the owner has taken the time to review the bank statements each month. Do not give an employee an unopened bank statement—doing so would defeat the purpose of having the statement mailed to the owner’s residence.

Employee Manual – A properly prepared employee manual should clearly spell out inappropriate employee behavior and provide guidelines as to proper procedures that employees are to follow. For example, how to request expense reimbursement or the proper use of company credit card.

Job Description – Each employee should have a detailed job description. This helps eliminate incompatible job assignments and makes employees accountable for any breakdowns in internal controls.

Insurance – Each employee that is in a position of trust or has access to cash should be bonded.

Background Checks – At a minimum, prior to hiring accounting and financial personnel, perform a criminal background check and verify references.

Observation – Observe whether any employees are living beyond their means, such as driving luxury vehicles, moving to a more affluent neighborhood, wearing expensive clothes or jewelry, taking exotic vacations or spending excessively on luxury items. These are red flags—ignore them at your own peril.

Fraud Hotline – Implement an anonymous hotline as a way for your employees to report unethical or illegal activity at any time.

Report to Insurance Company – Report fraud claims to the insurance company in a timely manner in order to adhere to the provisions of your policy and to prevent the insurance company from using this as a reason to invalidate potential payments for losses.

Report to authorities – Pursuing criminal charges will deter other employees and could result in a recovery of the theft. Some fidelity policies require reporting the fraud to the authorities prior to paying on any claim.

These are some simple suggestions to deter employee theft at your company. Remember most employee theft requires motive/pressure, rationalization and opportunity:

- Pressure = Financial needs (e.g. medical bills, gambling habit, divorce, peer pressure)
- Rationalization = “I will pay it back” or “I don’t get paid enough”
- Opportunity = Weak internal controls

Most business owners don’t believe their employees will embezzle funds from their company. Instead of hoping employee fraud doesn’t occur, proactively establish processes that reduce the risk of fraud occurring even if an employee wants to steal from the company. Remember, many times it is your most trusted employee that steals from you because you have provided the opportunity.

For more information on **fraud prevention in the workplace**, Contact **Howard Klein** or **Frank Suponcic** in our **Valuation and Litigation Advisory Services Group** at 440-449-6800.