



Deterring and Detecting In-House Fraud

Employee embezzlement can be a huge financial problem for the unwary business owner. And a business without good internal controls will tend to breed insider theft. A common thread running through businesses victimized by embezzlement is the lack of adequate checks and balances. Owners are often too busy working to build their business, all at the expense of neglecting their business. In other words, even the shrewdest business owner can be far too trusting of the wrong people.

Here are some helpful tips to reduce your risk of embezzlement:

Assess the controls in place with your accounting system. Many inexpensive accounting software packages that might be appropriate for low-moderate volume businesses are touted by bookkeepers and controllers as being simple to use, highly flexible, and easy to adjust. Quickbooks is only one such example. Unfortunately, such systems can easily be manipulated by a dishonest employee. For example, an embezzler could change the name of a payee in the system after generating a check to himself or a family member. Or he could purposely conceal certain monetary transactions. Or perhaps he could inadvertently fail to record deposits thereby creating unaccounted-for excess funds in a bank account. There are many other ways to deplete cash while escaping detection. For these reasons, as a business grows, there comes a time when an upgrade to a more suitable accounting system is warranted.

A good way to protect the business is for the business owner to get the bank statements mailed to him at home, open them himself, read them, and look at the list of deposits and cancelled checks. Resist the temptation to have the same employee open your business mail, write checks, make deposits, handle creditor calls, and reconcile the bank accounts. Be careful about letting an in-house accountant have unrestricted access to your accounts online. Be vigilant with an employee who insists on regularly working from home on a laptop and brings electronic copies of your accounting records home with him. Make it clear that new vendors may not be added without your approval.

Another way to reduce your risk of employee fraud is to evaluate your internal controls. Internal control services are one of the services Large & Gilbert offers to help business owners deal with embezzlement concerns. Internal control services aim to help business owners better understand their internal control structure and how they can improve it. We can do as little as completing a study of your current structure or as much as suggesting a new or improved structure with detailed job descriptions. Please keep in mind that financial statement audits and reviews are not designed to illuminate instances of fraud. If you are concerned about possible embezzlement, please contact our office to inquire about our services created specifically to address this issue.

Think twice before making your employees officers of your business. After all, the very definition of embezzlement is the fraudulent conversion of property of another by a person in lawful possession of that property because of a relationship of trust and confidence, such as a corporate officer.

Look for the typical warning signs of a potential embezzler. Embezzlers are usually highly trusted employees where something has gone wrong in their personal life. It could be a medical or financial hardship, a divorce or a mental problem. New employees, by contrast, rarely commit theft – they have not built up an atmosphere of trust and do not have rights to access cash, credit cards, lines of credit, and the accounting system that would document any fraud. Most small businesses lack adequate layers of control. Many business owners feel they should not have to look over a bookkeeper's shoulder.

Common red flags are receipt of an IRS notice that payroll taxes have not been paid or a bank statement reflecting Non-Sufficient Funds (NSF) charges. Another warning sign is the trusted employee who never takes a vacation. Embezzlers usually feel they need to be around 100% of the time to continue perpetrating a cover-up. Mandatory vacations are a preventative measure that really pays off.

If you suspect employee wrong-doing, your first order of business is to conduct a diligent investigation. When something big goes wrong, it is tempting to assume deliberate misconduct everywhere. Be careful of making false accusations against employees. Your investigation should be geared to identify the source of the problem: was it confusion, miscommunication, misunderstanding, lack of care, lack of competence, laziness, or genuine dishonesty? A reasonable investigation also requires that you look at everyone who had some connection to the bad event. The closest person to it is not always the perpetrator. Intuition or gut feeling does not replace a diligent investigation and you might consider using a professional if you do not know how to perform the investigation or if you cannot remain impartial. There may be the need to suspend employees while an investigation is underway. Suspending employees with pay is your right, for nearly any reason; however, suspending someone without pay is tantamount to accusing them of wrongdoing. Also, be careful of making statements about an employee that can be misconstrued as defamatory.

If it is determined that an employee has indeed embezzled from you, then do something about it. Many businesses victimized by embezzlement fail to prosecute. Instead, the employee is simply discharged and winds up resurfacing somewhere else, where the act of dishonesty is repeated. According to the U.S. Chamber of Commerce, \$50 billion is lost annually due to employee theft and fraud. Cooperation with law enforcement to ensure that thieves are punished for their crimes is essential to avoid a cycle of criminal activity.

It is possible that your business insurance policies provide coverage up to certain policy limits for employee theft. If there is any possibility of coverage, consider making a claim – after all, that’s why you have insurance! If your current insurance does not provide this type of protection, there are insurance policies out there that can be utilized for just this purpose.

Above all, keep in mind that prevention should be your first order of business. Screen your job candidates, check references, obtain consent to do background checks, including both police and credit checks. And then heed your accountant's advice when it comes to internal control, accounting software, and accounting systems.

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