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Identify and Prevent Employee Dishonesty Threats

By Mike Rosenau

Employee dishonesty can be damaging to both your business' bottom line and reputation. Losses, otherwise known as occupational fraud, can result from theft of money, securities or other property of the employer. A recent report from the Association of Certified Fraud Examiners (ACFE) found that the typical organization loses an estimated 5 percent of its annual revenues to occupational fraud. In that same study, the ACFE found the median loss caused by occupational fraud was \$140,000. This is a loss no business or organization can afford.

PROTECT YOUR BUSINESS

Understanding some elements of occupational fraud may help business owners realize what steps are necessary to mitigate it.

- 1. Motive:** The employee could be under a high amount of financial pressure.
- 2. Rationalization:** Employees who commit fraud must be able to justify it to themselves. They know it's wrong but they may rationalize that they're not being justly compensated for their work, the theft won't harm anyone or the employer deserves it.
- 3. Opportunity:** Individuals who commit fraud recognize the chance to get away with it. Scenarios can range from a lack of cameras in sensitive areas, frequently absent owners or management, or too much trust or responsibility given to too few people.

IDENTIFY RED FLAGS

It's important to understand you can protect your business. For most of the concerns above, red flags may alert you to problems. A red flag is a set of unusual circumstances or something that varies from normal activity. And it's a signal something should be investigated.

While of a general nature, here are some red flags that may warrant a closer look:

- 1. Employee lifestyle changes** (expensive cars, jewelry, homes, clothes)
- 2. Significant personal debt and credit problems**
- 3. Behavioral changes** (an indication of drugs, alcohol, gambling or fear of losing the job)
- 4. Refusal to take vacation or sick leave** (many violations are discovered while the perpetrator is on vacation)
- 5. Lower deposit amounts than expected** on busy days

PREVENT FRAUD

One aspect of fraud prevention includes thorough fraud detection training. Teach employees and managers the impact fraud can have on the organization, what constitutes fraud, the warning signs of fraudulent activity and how to report suspicious behavior.

Another fraud prevention measure includes implementing internal controls. Internal controls help ensure efficient operations, compliance with laws and regulations, safeguarding of assets and accurate financial reporting. These policies and procedures should address:

- 1. Separation of duties:** Implement a practice in which two separate employees are responsible for recording and processing a transaction.
- 2. Access controls:** Restrict access to physical and financial assets and information, including online financial information such as bank accounts and credit card transactions, to authorized employees.
- 3. Authorization controls:** Develop and implement policies to determine how financial transactions are initiated,

authorized, recorded and reviewed.

- 4. Policies:** Establish and communicate strict policies for accessing company assets such as business inventory.
- 5. Exposure to cash:** Monitor cash transactions closely and request receipts for all transactions.
- 6. Audits:** Institute regularly scheduled and occasional random audits by a qualified financial professional such as a CPA.

In the event of fraudulent activities, it's important that business owners have a fraud reporting system in place. Employee tips are what most often uncover occupational fraud. Institute an anonymous reporting system for employees, vendors and customers to report any violations (suspected or actual) of policies and procedures. Craft and implement anti-retaliation policies that actively encourage employees to report suspicious activity.

It's also a best practice for business owners to conduct extensive background checks on those who have access to company funds and other resources. For example, Society Insurance has a close relationship with a background screening company. Through this relationship, Society is able to offer its insured business owners discounted background checks. Society also has its business owners consult with risk control professionals to identify weak security areas and minimize fraud.

Employee fraud and dishonesty take a toll on businesses of all sizes. But by understanding what may be at the root of fraud and being able to identify potential red flags, you will be able to take action to prevent business-damaging events. *TLW*

Editor's Note: Mike Rosenau, MBA, CSP, ARM, is risk control manager at Society Insurance.