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Is Your Business Safe From Employee Fraud?

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In Hawaii, where employees and companies face the "high cost of paradise," there is a greater propensity for businesses to experience financial losses due to employee fraud and embezzlement. Preventing such losses starts with you, the business owner.

Emerging small businesses are especially vulnerable, because of the closer, more trusting relationship owners/managers often have with their employees, and the generally casual or less sophisticated internal financial controls they may have in place. No matter how trustworthy employees may seem, opportunity seeded by lack of preventive measures generates temptation. Combine this with the pressure that some individuals face from consumer credit debt or other financial burdens and an otherwise ethical employee might easily resort to fraud.

COMMON EMBEZZLEMENT SCHEMES

Employees commit crimes because they believe they won't be caught. Typical schemes include:

- Cash transaction fraud – the employee receives cash and pockets the money without making a record of the transaction.
- Accounts payable fraud – the employee sets up a dummy supplier and falsifies documentation and payment on fictitious purchase transactions. Payments are mailed to an address controlled by the employee.
- Payroll fraud – the embezzler adds names of fictitious individuals to the company payroll, thereby collecting additional salaries.

CLUES TO TIP YOU OFF

Look for warning signs that might signal fraud:

- Unusual employee behavior such as living beyond their means.
- Becoming highly territorial over the accounting function, especially if the employee is solely responsible for accounting. While this may be perceived as dedication, it can also mask embezzlement.
- Diminishing cash flow despite seemingly busy operations could be a sign that cash is being siphoned off.
- An unusual decline in cash sales could be attributed to unrecorded sales pocketed by the employee.
- An atypical volume of refunds or credits could be concealing accounts receivables theft.
- Unusual bad-debt write-offs could be covering up a fraudulent scheme.
- Inventory shortages could be a result of phony vendors, unrecorded sales or plain employee pilferage.

LOW-COST PREVENTION TACTICS

Here are a few ways you can protect your business from would-be embezzlers:

Understand your books. Team up with a knowledgeable, experienced CPA and ask a lot of questions, especially if the numbers don't look right.

Keep duties separate. No single employee should be responsible for a financial transaction from beginning to end. The person preparing the check for your signature should not also be in charge of accounts receivable, opening mail and performing the bank account reconciliation.

Monitor daily deposits and use dual control procedures for cash. Personally prepare daily cash deposits or compare company deposits made by employees with the record of cash and checks received. Get a copy of the duplicate deposit slip or other bank documentation.

Receive your bank statements personally. Receive unopened bank statements and cancelled checks monthly. Review checks carefully—examining payees, signatures and endorsements. Look for indications of fraud such as:

- Checks to suppliers or people you don't know.
- Checks made out to cash that are larger than your normal petty cash amounts.
- Signatures that look forged.
- Missing or out of sequence checks.
- Checks in which the payee does not match the name in your register.
- Checks made to a third party but endorsed by someone in your company.

Closely guard your company's checks. Keep them locked up and have a "voided check" procedure requiring validation of all voided items. Never sign a blank check.

Personally sign every payroll check. Though time consuming, it's generally worth it. Keep a weekly count of the number of people on your payroll and verify it against the number of paychecks. Ensure that changes cannot be made to your company's payroll master file without your approval.

Employee awareness and training. Employees who are in a position to mishandle funds should be adequately bonded. Inform employees that fidelity coverage is a matter of company policy, and you will prosecute cases of employee fraud.

Emerging, growing businesses often cannot survive significant losses from employee theft. Prudence demands measures to prevent the possibility of employee fraud. The survival of your business depends on it. ■