

Don't Be a Victim

A common concern, as unfortunate a sign of the times as it may be, is the prevention and, when that doesn't work, the detection, of fraud and embezzlement. Once a business has other than the owner working in it, there is a concern as to whether that employee (or co-owner) is in any way taking personal advantage of company assets/funds in a fashion that would suggest fraud or embezzlement.

Certainly, in most situations, this is not the case. Fortunately, most employees, as well as most co-owners or partners, are honest people who do not steal from their employers. However, we need always be vigilant to make sure that the few who would steal are prevented from doing so, or are discovered as early on as possible.

It is also most important to recognize that the failure to prevent these types of illegal actions, and then the compounding of that failure by failing to detect them when they happen, tends to engender a culture or philosophy among the employees of any company (or firm – law firms are not immune from these problems) that in effect rationalizes these types of actions somewhat along the lines of “Joe or Jane has been stealing from this company so long, management must know about it and not care. If that's the way this company operates, I guess it's okay for me to get my share.” Your failure to make it obvious that you will not tolerate this type of action simply encourages the weaker of your employees to follow what they perceive to be the crowd.

Fraud and embezzlement most commonly occur where internal control procedures of a business are poor or lacking. Such a condition is not all that unusual for many small businesses – it would simply take too many people to allocate administrative responsibilities in a fashion so as to (nearly) guarantee the prevention of wrongdoing. However, many times, even in larger organizations, we see weak internal control procedures that invite the unscrupulous to take advantage. It is strongly recommended that businesses ask their outside accountants to get involved with an analysis of their procedures, specifically engaging the accountants to do an internal controls procedure with an eye towards preventing and detecting fraud and embezzlement. Have that accounting firm come back to you with solid recommendations for improvement. In many situations, those actions will pay for themselves many times over and almost immediately.

To get an idea if you are at some level of exposure, ask yourself questions such as “How much latitude does my controller or bookkeeper have; how many hands control the receipt of funds and the depositing of them into the bank; how difficult is it for one individual to make entries into the accounting system; who does the bank reconciliations (it is often the same person who receives income and deposits it); who reviews purchase invoices, and who checks calculations on purchases and sales?” Very often the answer to these questions is that one or two people have an extraordinary amount of responsibilities (and therefore power) within a business entity.

What we have seen all too often is that a business will look to save a few dollars in pushing too many responsibilities on one or two individuals, rather than distributing those responsibilities more reasonably. Even for a medium-sized business, while there is a natural reluctance to hire

someone without an obvious and pressing need for that position, there are many times when the facts are such that a less tight-fisted attitude towards running your business would clearly show that another employee is necessary, various responsibilities should be allocated, and that the company will benefit from these actions.

There are any number of business operations which compound the above shortcoming by then holding back on using its outside accounting firm by not asking it, let alone allowing it when it is raised as an issue, to do the appropriate internal control studies and recommend the implementation of the appropriate preventive measures. Even if you are unlikely to install such measures, even if the cost of doing same is unacceptable, merely doing the appropriate study and review of systems will almost invariably lead to recommendations for improvements that may not cost you anything – and in any case will certainly save you. Also, as a not insignificant intangible, the very process of your outside accountants rummaging around, being there, asking questions, sends a message to your employees that you are willing to commit resources to prevent this type of theft.

Whether for your own business, or for that of clients, the following are warning signs of situations with a greater than average possibility for fraudulent activities:

- ✚ Were there any changes in ownership recently, even in part – and did a large order or a loan request follow that change?
- ✚ Do you have someone in a sensitive financial position, who repeatedly is late in reconciling bank accounts and who repeatedly postpones the outside accountants?
- ✚ Was a financial statement submitted to you, perhaps for credit purposes, a copy rather than an original?
- ✚ Does an employee appear to be in debt and repeatedly experiencing financial problems?
- ✚ Has the company experienced recent and frequent changes in key personnel, outside professional and bank relationships?
- ✚ Are there too many photocopies of invoices in files instead of originals?
- ✚ Do bad debt write-offs occur too frequently?
- ✚ Are certain costs or ratios out of sync?

The above are merely some of the flags that should make you (even the non-trained eye) concerned and more aware of the possibility of fraud and embezzlement. If you, or any of your clients or business relationships, are in a situation that seems to be in concert with anything described above, give it some extra attention and consider taking the appropriate preemptive action.