

RISK

management

Fraud and Theft Start Small

By Gary D. Zeune, CPA

It starts small and just gets bigger, and bigger, and bigger, until someone notices. Why? Because like children, people are “testing the system” (i.e., internal controls). Further, the things they can do with YOUR money are new – vacation, jewelry, cars, homes, dining out. Like being on drugs, the newness wears off, so it takes bigger and bigger “hits” to get the same high. So the amounts stolen grow.

Nearly all the grief our profession has been getting lately stems from the giant fraud schemes and audit failures that make the front page of your daily paper. We read the articles and think they don't apply to our company or firm. Unfortunately, that's wishful thinking.

According to the Association of Certified Fraud Examiners, the average organization loses 6 percent of revenue, or \$9 per day per employee, to fraud and abuse. Think about how many dollars in sales it takes

to recoup that. So why don't we realize the magnitude of these losses? Because they're scattered all over the financial statements.

A little T&E abuse, inventory that walks off, a purchasing agent who has a “special” arrangement with a vendor – or even a bogus vendor – whose invoices he approves, a salesman who gets bargain prices on purchases because he's giving unnecessary discounts on your product or service – that's all it takes for fraud to invade your company.

Making It Worse

If we grouped all these losses in a line item on the financial statements called “Fraud, Theft & Abuse,” we'd pay attention. We might even do

something about it.

Unfortunately, we make things worse. How? If our company takes inventory, what do we call missing inventory? “Shrinkage.” The

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inventory didn't shrink; someone stole it, or it was ruined or given away. Then we compound the problem by burying the missing inventory in Cost of Goods Sold. But it wasn't sold.

It's Ok, the Boss Is Doing It
Some employees feel justified in taking advantage of a company Why? Because times are tough and a few friends have been “downsized.” Or because employees who have left the company haven't been replaced. Either way, everyone is doing multiple jobs, for no increase in pay, while the owner is still living as though nothing has changed. Employees become resentful, and a few will figure out a way to get even.

Behaviors That Drive Fraud and Abuse

So how do you minimize the probability that your company or firm will fall prey? One way is not to hire employees who will steal you blind. You should do background checks on any employee who can do you harm, especially those with direct access to liquid assets.



- Do a criminal background check.
- Perform a civil background check. People who are being sued are more likely to do you wrong.
- Check the driving record. People who get lots of traffic tickets sometimes like to see if they can break the rules without getting caught.
- Perform a credit check. Employees who can't pay their bills have to come up with the money somehow. It might be yours.

There are hundreds of reasons why employees feel they have a right to your money. But it nearly always involves a "financial stress."

So how can you minimize employees using your assets for their benefit? Watch for behaviors that require

money: drugs, alcohol and gambling are the three big fraud risks listed in SAS 99 (the new fraud auditing standard effective December 15, 2003). Stealing to support an extramarital affair is another major driver. It also could be a sick child, a messy divorce – or simple greed. I've NEVER heard an employee or manager say, "I think I'll have an affair in a couple of years. I'm going to save up for it."

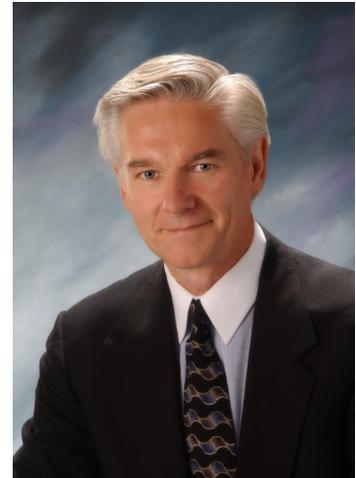


patients is basic disease prevention, yet the Centers for Disease Control and Chicago's Northwestern Memorial Hospital found that the influence of the senior doctor is so great that if he does not wash his hands while making rounds, the staffers with him will wash their hands only about 10 percent of the time.

Business owners who use the company as a personal piggybank shouldn't be surprised when employees take what they think is their fair share. If you want employees to do the right thing, then you must do the right thing.

Protect Yourself

This isn't rocket science. The best way to protect yourself is establish a culture where employees, management, vendors, customers, and clients are expected to do the right thing. Then make sure you walk the talk – even when no one is watching.



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Do You Wash Your Hands?

People behave the way they see those above them behaving. We all know that hand washing between