

Fraud: If someone's stealing, it's probably your friend

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A prominent CPA who has practiced on Long Island for many years recently observed, "You never get embezzled by someone you don't trust!" Businesses of all sizes are vulnerable to so-called "double agents" – individuals who profess to be loyal employees when in truth they are putting their own financial interests above all else.

Many companies mistakenly believe they have sufficient internal controls in place to eliminate the possibility of fraud. The problem is, many of the firms that were the victim of employee theft had the same mistaken belief. What, then, is an employer to do? Some guidance can be found in the Association of Certified Fraud Examiners' *2006 Report to the Nation on Occupational Fraud and Abuse*. The report is based on 1,134 fraud cases nationally reported by the certified fraud examiners who actually investigated these cases. The conclusions can be instructive:

- The median time from the commencement of the fraud to its discovery is 18 months.
- Private companies were victims of fraud 37% of the time versus public companies, which were victimized 32% of the time.
- Small businesses (100 employees or less) tended to suffer disproportionately larger losses compared to bigger organizations.

Interestingly, the report states that the initial detection of occupational fraud occurred by tips 34% of the time, accidental discovery 25% of the time and formal audits 20% of the time. Sadly, internal control programs, most of which are often poorly conceived and executed, were successful in detecting fraud only 19% of the time. External audits (12%) and police notification (4%) rounded out the study's observations. The report also indicated the top three methods of employee theft were check tampering, skimming and billing scams.

Business owners can adopt a measure of fraud protection by increasing the tips and accidental discoveries that bring fraudulent conduct to light. In this regard, companies would do well to follow the lead of the federal government in the areas of defense contracting

and health care; organizations that do business with the government are required to adopt corporate compliance plans to insure that fraud opportunities are minimized.

The Office of Inspector General for Health and Human Services has published compliance guidance for various health care providers (www.hhs.oig.gov), which can be used as a source for any employer interested in creating a compliance program. Such programs should include the publication of a company code of conduct, the designation of a compliance officer, the monitoring of the company's vulnerable systems and providing a "hot line" by which employees/contractors can report violations.

Louis Nizer, the famous trial lawyer, once defined luck as "preparation meeting opportunity." Create your own luck by applying some basic organizational processes. For instance, everyone in your company should be required to take at least one, and preferably two weeks of sequential vacation each year. This policy was used initially in the banking sector to determine if a teller's absence would uncover any improprieties.

Further, a company code of conduct need not be a 20-page dissertation (arguably, the best code of conduct was handed down on Mt. Sinai on two stone tablets). Regardless of the length of the document, of

utmost importance is senior management buy-in. If a code is only given lip service by management, don't waste your time creating one. Management must set the tone of honesty and integrity they expect in their employees; further, not only must management lead by example, it should reward ethical actions by employees.

The report also indicated employers were somewhat reluctant to turn offending employees over to law enforcement for fear of "bad publicity." However, once caught, it is critical that the offending employee be prosecuted. This not only sends a clear message that the company has a zero tolerance policy where employee fraud is involved, but studies show active and vigorous prosecution acts as a substantial deterrent to future lawbreakers. Companies also sometimes seek to cut deals with high producing sales personnel or others highly visible in the community. This is a mistake. Exceptions constitute a double standard that will doom any company's attempt to establish a viable, credible code of conduct.

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