Protecting Your Organization Against Fraud

The former treasurer of a non-profit pleaded guilty to embezzling from the organization more than $310,000 over a four-year period.

An employee of an upscale department store was found guilty of stealing (one bottle at a time) more than $330,000 in Chanel merchandise over a five-year period.

An employee of the Washington State Gambling Commission was convicted of embezzling $70,000 to cover gambling debts.

Regardless of whether you own/operate a profit-seeking or a non-profit organization, or run a governmental agency, fraud can occur and go undetected in your organization unless you take pro-active steps to prevent, detect, and correct the situations that can lead to it. Accountants usually classify frauds as either fraudulent financial reporting or misappropriation of assets. Because of limited space, I will restrict the discussion here to misappropriation of assets by employees.

There are three factors that lead to fraud against organizations: incentives/pressures, opportunities, and attitude/rationalization. Understanding these fraud risk factors will help you to identify the risks that fraud may occur in your organization. Implementing strong internal controls should help reduce the opportunities available to commit fraudulent actions.

Incentives/Pressures
The incentives/pressures employees face that can lead to misappropriation of assets include, but are not confined to, such things as high personal debt, financial losses, living beyond one’s means, excessive gambling, perceived inequity in the organization, and corporate or peer pressures. While most of these pressures are beyond the control of the organization, the concerned owner/manager can set the tone for helping employees deal with the personal issues that might lead them to commit fraud. An open communication system is one step in the right direction. This may allow you to know employees well enough to determine when they may be facing what appears to them to be insurmountable problems. You may then be able to help them get counseling and guidance before a fraud occurs.

Opportunities
The opportunities to misappropriate assets can be reduced significantly by recognizing where the opportunities are and designing your internal control system to prevent or detect the
fraudulent acts when they occur. Individual employees may create opportunities. However, most opportunities are organizational practices that make it easier for employees to commit fraud. Some of the more basic opportunities are created when organizations fail to adequately screen when hiring or promoting individuals into positions of trust; placing too much trust in certain key employees without verification of their work product; allowing employees to develop too close an association with suppliers or others with which the organization does business; failing to inform employees about the organization’s vision, goals, code of conduct, policies, and procedures; and having dishonest or unethical management.

**Attitude/Rationalization**

The last two opportunities listed can lead employees to rationalize their actions. If an employee’s direct supervisor/manager is dishonest or unethical and the employee sees this, the employee could very well rationalize his/her own dishonest/unethical behavior. Without a firm understanding of the organization’s vision, goals, code of conduct, policies, and procedures, the tempted employee has nothing to fall back on. The “everybody’s doing it” mentality can survive and even thrive in this environment.

In summary, while owners/managers do not have control over all incentives/pressures (other than those that relate to disaffection with the organization), they do have the means to recognize when these might be affecting their employees and can take action to help employees work things out. Owners/managers can have a great deal of control over the internal control environment in their organizations by taking simple steps to hire competent, honest employees; to inform employees about the organization’s vision, goals, code of conduct, policies, and procedures; to monitor employees’ work product (such as performing an independent bank reconciliation); and, most importantly, leading by example. The tone at the top is critical. Employees are always watching owners/managers. Conducting oneself with the utmost integrity will serve your organization well.