



PROTECTING YOUR COMPANY FROM EMPLOYEE THEFT



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Employee theft and abuse imposes an enormous cost on businesses. According to the *2006 Report to the Nation on Occupational Fraud & Abuse* (“*Report To The Nation*”) published by the Association of Certified Fraud Examiners (“ACFE”), the average cost of employee theft is \$159,000. US businesses lose 5% of their annual revenue to fraud. Compared to the U.S. Gross Domestic Product, this translates to approximately \$652 billion in fraud losses annually. Even more alarming is that the cost of embezzlement schemes at businesses with less than 100 employees is 20% more than at larger entities. The average loss suffered by the smaller organizations included in the Report to the Nation was \$190,000 per scheme!¹

If the impact of employee theft is so pervasive, the question becomes why and how do employees steal from their employers? Embezzler’s motives may vary from personal financial troubles to greed, jealousy or anger, but they are energetically creative in their methods and universally abusive of the trust placed in them.

One common method used to embezzle money from construction companies is the *theft of daily deposits*. This is a simple cash fraud scheme in which a partial or an entire deposit is stolen. In this case actual or expected receipts do not equal the deposits for a specified period.

Accounts receivable fraud is also a popular activity among employee fraudsters at construction companies. This type of fraud involves the manipulation of customer accounts receivable and sales in order to steal cash and other assets from an unsuspecting employer.

Lapping customer accounts, a common form of accounts receivable theft, involves stealing a customer payment made on account and concealing the theft by applying a payment from a second customer to the account of the first customer whose payment was stolen. The misappropriation of the second customer’s payment is concealed by applying the payment of a third customer; the payment from a fourth customer is applied to the account of the third customer and so forth. Typically the embezzler steals more than a single payment. Employees involved in lapping schemes must have access to and responsibility for customer billings and receipts. Since invoices to different customers are usually not for the same items or dollar amounts, this cumbersome scheme eventually falls apart especially if the perpetrator goes on vacation or is out of the office for any period of time.

Inventory schemes involve scrapping good inventory and selling it, using sales return schemes and purchasing frauds. Stolen inventory includes raw materials, such as lumber and finished goods for personal use or for resale by the employee causing unexpected or frequent out-of-stock conditions, and unexplained increases in cost of goods sold with corresponding reductions in gross profit margins.

Other assets are stolen less frequently than cash or inventory. They tend to be small in size, portable, lack owner identification and are easy to sell. Unusual or frequent purchases of certain types of equipment, such as laptops and PDAs, could be indicative of asset fraud.

Payables and disbursement fraud often involves collusion with other employees and/or third-parties. *Kickbacks* are a favorite because they generally enrich the employee without employer awareness. In this scheme, an employee with the authority to purchase materials or services receives a benefit from a vendor in the form of cash, gifts, services, trips, or employment favors for relatives. In return the employee may buy inferior or excess goods and services, or agree to pay a higher price. Since employees in management positions who have the power to override internal controls are often involved, kickback schemes can go on for a long period of time before being discovered.

Inflated or false invoice schemes are often undetected for the same reason. In these cases employees submit false invoices for payment or they purchase goods and services in excess of the company's requirements, stealing company funds. The authority to approve payment, or they conspire with someone who has the authority. Employees also plot with vendors to submit inflated or bogus invoices.

When it comes to embezzlement, the single biggest deterrent to preventing fraud is to let employees know that someone is watching. Oversight methods that can be used by contractors include:

- ***Get personally involved.*** Understand the administrative processes of your construction company and, if feasible, retain exclusive authority for all write-offs and vendor payments.
- ***Segregate job duties.*** Distribute responsibility for receipts, postings and deposits, even if it means doing the reconciliations yourself. Cross-train employees and rotate duties in the office.
- ***Establish daily reconciliations/deposits.*** Match daily receipts to deposits. Directly deposit payments and instruct the bank to send bank statements and canceled checks to your home.
- ***Conduct background/credit checks on all employees.*** Investigate past job history and credit reports to assess fraud risk.
- ***Secure fidelity bond/employee dishonesty insurance.*** Coverage is inexpensive and may reimburse losses from embezzlement and non-employee theft.

- ***Encourage employees that witness a fraudulent activity to come forward.*** One-third of fraud cases in small businesses are detected through tips of which more than 60 percent come from employees.²

Embezzlement is one the most insidious crimes for any business, but it can be prevented with internal controls and a method of checks and balances. On an average, 42 percent of fraud victims recover none of their loss.³ Therefore, if you suspect that fraud is happening in your business, proceed quickly but cautiously using outside forensic experts, such as a Certified Fraud Examiner (“CFE”) or Certified Public Accountant (“CPA”) to help build the case for a favorable outcome.

As one of the leading accounting and profitability consulting firms for the construction industry, Cowan, Guteski & Co., P.A., has extensive experience in forensic accounting. Contact William McNamara, CPA – Director, Construction Services Group at 732-349-6880 extension 116 or bmcnamara@cowanguteski.com to learn what you can do to prevent or detect employee fraud.

About Cowan, Guteski & Company, P.A.

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Footnotes:

1. American Certified Fraud Examiners, “Report to the Nation on Occupational Fraud & Abuse,” 2006 from <http://www.acfe.com/documents/2006-rttn.pdf>.
2. Ibid
3. Ibid