

# CYBER RISKS & LIABILITIES

## Proper Employee Management to Reduce Occupational Fraud

It's an employer's worst nightmare—an employee is dissatisfied with his or her job and decides to defraud or steal from the company. There are plenty of stories about employees committing these crimes and causing enormous damage. By recognizing signs of occupational fraud and implementing practices to prevent it, you can lead a happy and productive workforce.

### Occupational Fraud Facts

Types of occupational fraud include embezzling, insider trading, forging checks, expense reports and vendor invoices, or any other type of internal fraud.

According to a 2012 occupational fraud report by the Association of Certified Fraud Examiners (ACFE), the typical organization loses 5 percent of its annual revenue to fraud. It also reported that the median loss caused by fraud was \$160,000. For a small company, this could mean the end of the business. Small businesses are more at risk because owners inherently treat their employees like family, leading to complacency and lax security measures. Small businesses also tend not to have anti-fraud measures in place as many lack the know-how and enforcement capabilities of larger businesses. Nearly half of victim organizations do not recover any losses that they suffer due to fraud.

### The Fraud Triangle

Certain conditions must be met for an employee to commit occupational fraud—these three conditions are known as the “fraud triangle.”

1. **Motive.** The defrauder must have a motive to commit fraud, and this motive is often pressure. This can come from feeling too much stress at work to meet deadlines or trying to live a lifestyle that is above his or her means. Outside

problems can exist as well, such as a gambling addiction. Monetary gain is often the motive behind occupational fraud.

2. **Opportunity.** If anti-fraud measures are too lax, the opportunity can be there for fraud to occur. Even if the perpetrator is financially stable, the opportunity to commit fraud for financial gain might be too much to pass up. Being employed in a high-level, trustworthy position can also lead to opportunity.
3. **Rationalization.** The perpetrator must be able to justify his or her actions. If employees sense some sort of wrongdoing from the company, they might be able to justify the fraud. They may also tell themselves they are just “borrowing” money from the company with no intention to pay it back, or they might feel entitled to a raise and will commit fraud to give themselves that “raise.”

Understanding these conditions can be the key to recognizing if occupational fraud is occurring at your business.

### Recognizing Occupational Fraud

It is often difficult to recognize when occupational fraud has occurred. Frauds last a median of 18 months before being detected, according to the ACFE study. Occupational frauds are much more likely to be detected by tip than by any other means. Because of this, many companies have set up employee tip lines to try and catch the person(s) responsible for wrongdoing.

While detecting occupational fraud may be a difficult task, there are a variety of warning signs that an



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employee might be defrauding your business, including the following:

- **Invoices from fake vendor** – an employee can create a fictitious vendor, mail a check to the fake vendor with your business' name on it and then cash the check for themselves.
- **Missing property** – laptops or other computing equipment can be an easy target for employees.
- **Fraudulent expense reports** – some company reports are merely skimmed over for approval, offering an employee an easy way to fake expenses.
- **Forged checks** – if an employee consistently works around a high-level executive, it becomes easy for the employee to forge signatures.
- **Employee lives beyond his or her means** – if an employee is living a lavish lifestyle on a modest salary, he or she could be defrauding the business. Alternatively, an employee who is having financial troubles yet seems to be living within his or her means may indicate fraud is a possible cause.
- **Unusually close association with a competitor** – if an employee seems to have a close relationship with a direct competitor, he or she could be sharing your trade secrets in return for money.

## Preventing Occupational Fraud

- If you run a small business, chances are you have a few employees that are in charge of several different areas of the organization. Split up the duties among a larger pool of employees to decrease the likelihood of fraud.
- Perform a pre-employment screening on all potential employees. A resume might not tell the entire story about a prospective employee's past.
- Let employees know there are policies on employee theft in place. Don't assume they are already aware of the policies and the consequences of fraud.
- According to ACFE's study, more than 80 percent of the frauds in the report came from employees in one of six departments: accounting, operations, sales, executive/upper management, customer service or purchasing. Recognize these high-risk departments as potential sources of fraud and implement the proper policies to prevent it.

- Establish an anonymous tip line that employees, clients or vendors can use to report cases of occupational fraud.
- Don't get complacent. Any employee can commit fraud at any time. While most fraud is committed for monetary gain, that doesn't mean an employee won't commit fraud if the opportunity is there.
- Conduct random audits. Work with a CPA to set up and maintain effective internal financial controls to ensure you're not losing money as a result of fraud.

## Proper Employee Management

One of the best ways to prevent occupational fraud at your company is to ensure all your employees are satisfied with their work and the company as a whole. Lead by example—if you and your high-level management team conduct business properly and ethically, your employees will likely do the same. Good ethics also carry over into the market, where your company will be looked on favorably, which can lead to higher revenue and greater goodwill from the community.

Reward employees for doing well. Let them know how important they are to the success of the business. Don't emphasize only the things that haven't been achieved—focus on the positive, too.

## Insuring Against Occupational Fraud

Recognizing and preventing occupational fraud can be a daunting task. Contact HFG Benefits & Risk Management today. We have the tools necessary to ensure you have the proper coverage to protect your company against losses from occupational fraud and maintain a productive workforce.