

Corporate Law

Preventing Employee Theft

How to take appropriate steps to address the problem

By Kevin M. Hart

Various studies have been conducted by organizations such as the United States Chamber of Commerce, the United States Justice Department and the Association of Certified Fraud Examiners, all of which confirm the existence and scope of employee theft. There is a common thread in these studies, namely that the problem is large in terms of dollars, crosses all boundaries, and is increasing at an alarming rate. Employee theft annually tops \$50 billion, 10 times the value of street crime, or 1.5 percent of world trade. Close to 6 percent of all company gross revenues are lost to occupational fraud. Employee theft increases at a rate of 15 percent per year. Additionally, one-third of all small business failures are caused by employee theft.

In order to understand the nature of the problem, it is necessary to examine and correct several myths that management continues to believe.

Myth: Theft Losses Are Not Material

The magnitude of annual losses due to theft is estimated between \$50 and \$70 billion annually. A theft problem can have devastating consequences effecting in the

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most extreme instances the very survival of a company. The impact is more pronounced on small businesses.

Myth: Most Thefts Go Undetected

Most thieves eventually become careless and are discovered. Most are reported by co-workers (40 percent), many are discovered by accident (21 percent), and many are discovered by internal controls or audits (24 percent).

Myth: High Wages Will Prevent Employee Theft

There is no direct correlation between wages paid and the presence or absence of a theft problem.

Myth: Crime Does Not Pay

The benefits are immediate, and substantial. Very often companies are not willing to prosecute. An employee that begins to steal rarely considers the consequences of being caught.

Myth: Most Employees Will Not Steal.

Virtually all employees are susceptible to temptations in varying degrees. Studies show that for every 10 employees, two of the 10 employees would be very resistant to any temptation to steal. One of the remaining 10 employees is likely to be

a bonafide thief. You can only hope that you do not hire this person. The remaining seven out of the 10 are basically honest employees. However, even honest people are susceptible to temptation at some level. These honest employees will normally not steal unless something clouds their judgment. When one of the seven of 10 honest employees gives into temptation, they rely on rationalizations to justify their actions.

Areas Where Thefts Commonly Occur

Areas where thefts commonly occur are a) cash, b) accounts receivable, and c) accounts payable. The primary problem is usually a lack of controls and/or centralizing responsibility in one person. It is important that there is someone who verifies that invoices and payments are being properly recorded. There also should not be exclusive contact with a vendor by a single employee to prevent one person controlling all facets of a vendor relationship. There should be a monthly independent review of the bank account.

The most important step to prevent employee theft is to hire the right people. It is much easier and less expensive to prevent potential thieves from joining an organization than it is to apprehend criminals once they have been hired. In the hiring process, it is essential that personal interviews be conducted, that reference checks and credit checks be run. In performing reference checks, it is important to learn the reasons for someone leaving a position and identifying any other problems that occurred at previous jobs. It is not infrequent that a company terminates

an employee for a theft problem and passes this employee along to the next employer who undoubtedly will be the next victim. Credit checks are also important in order to determine whether the potential candidate has financial difficulties.

A company must establish and manage the climate of the organization. This requires management awareness. Theft is a state of mind. Prevention and control are merely states of awareness and caring. Physical security alone cannot solve the problem because physical acts are not the root of the problem; it is the mental attitude behind the acts. It is important for any company to establish a series of values and beliefs. The company must create a climate within the organization that supports and reinforces such values as honesty and integrity. It is important to give employees an understanding of the company's objectives and strategies.

Many companies have a written code of conduct. A Code of Conduct sets forth what the company considers to be theft. This removes any ambiguity. It is important that all employees understand what the company considers theft and more importantly what the consequences will be for those who commit such an offense. This can be reinforced in employee evaluations. This will motivate employees to adhere to the company's values. If managers are seen to deviate from the values even slightly, then employees may conclude that the values are not important. Creation of an appropriate moral climate in a company is a necessary precondition for the effective implementation of internal controls.

While fighting dishonest employees is an important task, educating honest employees is even more important. Every organization must define theft for its own particular needs and circumstances. Most owners and managers naively assume that all employees know what theft is, and that the employees

see things as they do. This is simply not true. A critical first step in developing an effective theft reduction strategy is to actually define what theft is. The process that you use to define theft should include participation by the employees.

Once the parameters of the plan have been decided, the next step is to institute a series of internal controls. Controls minimize errors and mistakes in transactions and record keeping. Controls can also safeguard assets such as cash and inventory that are easily misappropriated. Good controls also reduce the work of external auditors and decrease the costs associated with them.

Virtually all internal controls involve dividing employee responsibility in three ways: the authorization of transactions, the physical custody of assets, and timely record keeping with supporting documentation. If a single employee has two or three of these responsibilities, then the opportunities for theft and concealment are significantly increased. The first step in planning a control system is to study the company's operations thoroughly. The flow of assets, particularly liquid assets such as cash, securities or inventory, must be traced. Likewise, the flow of documentation and record keeping must be carefully identified. Once that is done, then questions must be asked to where there are particular weaknesses, how could a theft take place, how a theft could be hidden, and lastly, what could go wrong.

The other major factor with respect to deterring employee theft is the threat of prosecution. The amount of theft within an organization is normally inversely proportional to the perceived chances of getting caught. However, if an employee realizes that the company is not likely to prosecute an employee who is caught stealing, it will encourage other employees to potentially engage in theft. While this may sound, on its face, very simplistic, it becomes very difficult for management to proceed with

prosecution of an employee who is probably a long-term employee, has established a friendships with other employees, including management, and the perceived consequences to the employee's family.

If the theft is based upon financial difficulties, it becomes very apparent that by prosecuting the employee, the employee's family will suffer substantial hardships, both financial as well as societal. The embarrassment to a family when an employee is prosecuted extends far beyond the workplace. It extends into the community, the schools where the children of the employee attend, organizations or churches that the employee may belong to. The family will suffer much greater shame, embarrassment and probably financial hardships due to these actions. In this circumstance, it is very difficult for management to proceed with the prosecution knowing the ramifications to the family of the employee. However, a failure to prosecute undoubtedly will lead to further problems down the road.

Management's responsibility in this entire matter involves many considerations. First and foremost is honesty. Management must lead by example. If management is seen to use the corporate forum for personal benefit, it can only be assumed that this will lead to employees feeling that they, too, should be able to take advantage of the corporation. Management also has the role of establishing appropriate safeguards and to apply standards fairly across the board to all employees. It is important that the application of the policies be done without exception.

In conclusion, good and faithful employees are a business's most valuable asset. In order to maintain that asset, it requires the concerted effort to put into practice a philosophy that encourages, rather than discourages, a theft-free workplace. ■