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Small Businesses at More Risk for Employee Fraud

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The aftershocks of the financial crisis -- and the resultant increase in fraud risks for small businesses -- are often felt well past the time the economy officially begins finding its feet again, according to a pair of speakers at a recent continuing professional education (CPE) session hosted by the Syracuse Chapter's Members in Industry Committee.

While the fraud at major companies may often grab headlines, small companies with fewer than 100 employees are most at risk, accounting for 31 percent of fraud reports filed in 2010, according to data from the Association of Certified Fraud Examiners (ACFE) outlined during the presentation.

Though Joseph C. Szlosek, cochair of the Members in Industry Committee, said he usually associates fraud with "the Enrons of the world," logic would dictate that fraud is a bigger problem for smaller businesses "because they don't usually have the strongest internal control environments."

Out of internal control

Businesses' reactions to the economic downturn create conditions in which people are both more likely to perpetuate workplace fraud and less likely to detect it, pointed out Syracuse Chapter member Brian R. DuMond and Catherine Casler, an internal audit and accounting manager at Dermody, Burke & Brown, CPAs, LLC in Syracuse, who both spoke at the event.

Many businesses cut staff when the crisis hit in 2008, which increased the workload of existing employees and put stress on internal control processes. Companies doing more with less may not be able to segregate duties effectively, thus giving more people access to more systems -- a situation that usually does not bode well from a fraud-prevention standpoint, said Casler. In addition, companies in this position have fewer staff to check over more work, thus leading to weakened checks and balances, DuMond noted.

"Not only [is management] reviewing more reports and doing more things -- the information in the reports may not be as strong," he said.

Interpersonal office relationships can also suffer. As greater demands are placed on a smaller number of employees, resentments can surface among the staff, causing people who would not ordinarily consider defrauding their employer to do so, Casler said. This is particularly true if they were subject to other sacrifices, such as not getting raises. These employees may rationalize that secretly dipping into the company coffers is one way to get what they feel is deserved compensation for the sacrifices they've been forced to make.

It is important for businesses to maintain "an atmosphere of teamwork so everyone is sharing in the sacrifice or extra work, so … the employees are not inclined to help themselves to the company's assets," said Casler.

Beyond what goes on inside the company, events in employees' personal lives can also be a contributing factor in workplace fraud.

“Severe economic pressures can cause previously honest people to become dishonest,” such as an employee who has a child with a medical condition, DuMond noted. Data from the ACFE showed that financial difficulties motivate 44.7 percent of fraud cases in the United States.

Lingering problems

Though these risks generally affect companies as they react to the stress of a crisis, they may remain even after business starts to improve, DuMond said. Since businesses cut staff as a way to save money, they may not want to rehire full-time employees when work picks up, preferring instead to either add part-time workers or even outsource projects to contractors -- both of which can result in weak internal controls. In those cases, employees who remain will have even more work to do, and possibly feel more stress, than before the recession. In addition, the increased revenues can lead employees to even more strongly rationalize helping themselves to company assets.

The numbers prove this point, said DuMond: Roughly 90 percent of fraud cases center on asset misappropriation, a broad type of crime with many different subcategories. According to ACFE data, billing fraud represents the most likely of these criminal acts, at 26 percent, and can take place via seemingly innocuous transactions, such as when an employee buys personal items and submits the invoice to his or her employer for payment. Next on the list is the filing of fraudulent expense reports, which comprises 15.1 percent of cases, followed by skimming at 14.5 percent, in which case cash is stolen before it is even entered in the books.