



WORKPLACE CRIME: HOW TO DETECT AND PREVENT

By Christine H. Long

Every year billions of dollars are lost by businesses nationwide to employee fraud and theft. Small businesses are especially vulnerable to occupational fraud and less able to absorb a loss than a larger business; in fact, it is not unusual for a small business to be bankrupted by theft committed by a single employee. This article summarizes the arsenal of tools for preventing employee theft and the methods to respond if it is discovered.

Who Steals

Studies have shown that it is more often the younger employee under the age of 35 who steals from an employer. However, when older workers engage in theft they tend to take much more than their younger counterparts. Managers are the usual culprits for the worst cases of fraud. All too often, it is the long-term and trusted employee who ends up being the culprit. Often, it is someone who has been with a company for more than three years. Employees at private companies cause more losses than those at public or non-profit establishments.

Background Checks

It is important to know who is being hired. The term “background check” is very broad, and involves a wide range of rules and requirements. Background checks allow an employer to find out about the employee's previous work experience and encounters with law enforcement. Each company must decide whether the time and expense of such background checks is worth the return. At a minimum, an employer should check the background of any employee who will have regular access to cash, checks, credit card numbers, or any other items that are easily stolen.

With the availability of information via the internet, a wealth of publicly-available information may be easily located. Be mindful, however, that contracts with some social networking sites may limit the use of information stored thereon for purposes of background searches. Also, even if information is available – for example, information about an arrest that has not yet resulted in a conviction because the charges are still pending – it does not mean it can be legally considered for employment purposes.

Employment Application or Resume Requirement

Small companies and businesses routinely hire individuals with no resume, employment application or other document. The first step in any background check is gathering information directly from the job candidate. Applicants should provide information on their work history and their educational background.

Employers should also meet job candidates and take the time to ask follow up questions about their resumes and background. Relying on verbal interviews alone is risky. An applicant may ignore or gloss over long periods of unemployment or reasons for leaving a prior job. It is easy in a conversation for the discussion to jump around. However, if the hiring manager has a paper that asks for specific time periods of employment and reasons for leaving, he or she will have a roadmap that identifies questions regarding the applicant's job history. The hiring manager can then evaluate discrepant or incomplete responses to interview questions regarding gaps in the written application or resume. Gut instinct still goes a long way when making a decision to hire.

In gathering information from an applicant, avoid discrimination. An employer cannot single out individuals based on gender or ethnicity for certain types of questioning. For example, an employer who asks only African-American or Hispanic males under the age of 35 if they have a record of criminal convictions, or who checks the references only of employees who are of Asian ancestry and were not born in the United States, is likely engaging in discriminatory hiring practices. The best practice is to use the same hiring process for all applicants to the same job.

A thorough pre-employment background check should include:

- Criminal history for crimes involving violence, theft, and fraud (in California there is a limit on how far back you can check);
- Civil history for lawsuits involving collections, restraining orders, and fraud;
- Driver's license check for numerous or serious violations;
- Education verification for degrees from accredited institutions;
- Employment verification of positions, length of employment, and reasons for leaving.

Criminal Conviction Checks

Most public records services (such as Nexis or ChoicePoint) have criminal conviction records for almost every large county in the U.S. If not, an employer may go to the courthouse and search the criminal conviction records in the criminal courts division of the employee's county of residence (or other counties in which he or she previously resided).

In California, most employers are prohibited by law from inquiring about or considering information about an arrest that did not result in a conviction, convictions for certain types of marijuana-related crimes, or convictions which have been expunged. Because violation of these laws can be charged as a misdemeanor, employers who are undertaking their own criminal background checks should be sure that they know the limits of the information they can legally obtain and use.

Past Employment Verification

Even though most employers will only verify position and dates of employment, a prospective employer can often tell by the tone of voice what the former employer thinks of the employee. A prospective employer should consistently ask previous employers whether the applicant is eligible for rehire.

Drug Screening

Many companies are now conducting drug screenings for potential hires as well as current employees. People who are frequent drug users can be more prone to theft or fraud. However, there are strict requirements about how pre-employment drug testing can be conducted in California, who can conduct such tests and how information about the results is to be communicated. It is important to consult with either an attorney or an experienced HR advisor before implementing a pre-employment drug screening program.

Reference Checks

Amazingly, very few employers actually call the references a candidate provides. Most operate under the theory that someone would not provide a bad reference. However, many times people will list important-sounding individuals as references with the hope that they will not be called or on the false assumption that a former supervisor or co-worker will provide a good reference.

Even if the reference provided is limited to confirming job title, dates of employment, rates of pay and eligibility for rehire, such information can be quite revealing. It may show unexplained gaps in employment. Inflation of job title or rates of pay at a prior job, in order to obtain a more responsible position in a new job can be indicative of dishonesty.

Education and Certification Verification

While it is not imperative, it is always a good idea to verify the applicant's educational history. If the person claims to have a license or other certification that relates to the job he or she will be doing, make sure the license is current. Even if the employee is not going to be working under the license, it is good practice to verify the licensure to see if there is any history of discipline or if the license is no longer current. It is not uncommon for an applicant to claim a certification or license that has actually been revoked due to a disciplinary action. Most licensing or certification organizations will report if any disciplinary action has been taken against a particular individual.

Get the Consent of the Candidate – Requirements and Exceptions

Numerous federal and state laws, such as the Fair Credit Reporting Act, govern the gathering and use of information for pre-employment purposes. Many of these laws require that an employer obtain written consent from the candidate before gaining some types of information listed above. It is also a good idea to obtain a signed authorization and release from a potential candidate. Consult with human resources and/or legal counsel to ascertain the laws applicable to the particular company and to obtain the proper authorization forms.

In California, an employer may use an outside screening agency to conduct the investigation upon obtaining the written consent of the employee. Such written consent must disclose the purpose of the report; give the name, address, and telephone number of the screening company; and include a summary of the applicant's rights to see and copy any report.

NOTE: If a company does the background check, i.e. by asking for records, it is not required to use the same notice rights as stated above. However, California law requires certain written disclosures when investigating the "general background" or "mode of living" of an applicant and imposes restrictions on the type of information that can be obtained. Accordingly, the employer should be cautious to limit such self-directed inquiries to criminal convictions within the past seven years. The employer must also allow the applicant/employee an opportunity to see a copy of whatever reports you obtain.

The primary exception to the notice requirement is if the object of the investigation is already employed and suspected of misconduct. In that instance, the employer can obtain certain reports without providing notice of the employee's right to obtain a copy.

Policies and Procedures That Help Deter Fraud

The work culture fostered by the employer will go a long way in preventing fraud. This culture must be evident upon hire and reinforced by management. Employees who perceive that they will be caught engaging in occupational fraud and abuse are less likely to commit it. Increasing the perception of detection may well be the most effective fraud prevention method.

1. *Employee Handbook.* Write and distribute a company policy that outlines exactly what constitutes stealing. This includes not only outright theft, but also acts of dishonesty such as falsifying time records, taking a long lunch break without approval, using sick leave when not sick, deliberately doing slow or sloppy work, or coming to work late or leaving early.
2. *The Work Environment.* An efficient and positive work culture will prove to be a motivation for the right employees and a deterrent for dishonest people. The work culture begins with management and owners. A cavalier attitude toward rules and regulations by management will soon be reflected in the attitude of employees. Every employee — regardless of position — should be held accountable for his or her actions.
3. *Internal Controls - Auditing for Fraud.* Many organizations have found that developing audits that focus on high-risk areas are an effective part of their anti-fraud programs.

Companies should periodically assess their internal controls. Questions to consider include:

- a. Is there an effective separation of duties? For example, are different employees responsible for accepting payments and reimbursements versus handling accounting records? Are different people responsible for recording and processing a transaction? Does the same person send out bills, collect the mail and prepare bank deposits?
- b. Does a third party periodically inspect financial records and transactions for completeness and accuracy? Run irregularly scheduled surprise audits or have a third party audit financial records once a year. Also insist that the bookkeeper or any employee who has access to monies take a yearly vacation to allow independent examination of their computer, desk and records.
- c. Are duties adequately segregated for handling business management and billing systems?
- d. Are financial procedures documented and are spot checks periodically performed to make sure procedures are followed?
- e. Does the company computer system automatically and accurately reconcile transaction details with entries in the General Ledger?
- f. Are billing and accounts receivable systems segregated from activities involving collections?
- g. Is there a backup of all transactions kept on a daily, weekly, month and year end basis?

The areas where companies should consider conducting random audits include:

- Expense Reports
- Payroll
- Purchasing
- Sales
- Accounts receivable
- Customer complaints
- Cash

Additional tools that a company can employ:

Job Rotation. Some frauds are detected during sickness or unexpected absences of the perpetrator, because they require continuous, manual intervention.

EXAMPLE: A growing company began cross-training employees to help cover the increasing needs of the business. During the training it was discovered that the trusted thirteen year employee had been stealing for twelve years. Had there previously been job rotation or cross-training it is likely that the employee's theft would have been discovered much sooner. In fact, the employee's defense to the police was that her employer did not seem to care what she did and had they been supervising her more they would have known what she had done.

Surprise Audits Where Possible. All too many fraud perpetrators know when auditors are coming, and therefore have time to alter, destroy, or misplace records and other evidence. A proactive fraud policy involves using the technique of random or surprise audits as much as possible. It might have a significant deterrent effect.

Management Oversight. It is most common for employees who steal to use the proceeds for lifestyle improvements. Some examples include expensive cars, extravagant vacations, designer-label clothing, jewelry, new or remodeled homes, expensive recreational property, and outside investments. Managers should be educated to observe signs of extravagance, especially when they appear disproportionate to the employee's rate of pay.

EXAMPLE: Discovery of an employee who embezzled over \$1.1 million dollars when her assistant became suspicious of her extravagant lifestyle and brought it to managements attention.

Financial Controls. Putting in place certain accounting office procedures can prevent most fraud.

- Make sure all checks, purchase orders, and invoices are numbered consecutively, and regularly check for missing documents.
- Use a "for deposit only" stamp on all incoming checks to prevent an employee from cashing them.
- Personally look into customer complaints that they have not received credit for payments.
- Unopened bank statements and canceled checks should be received by the business owner or outside accountant each month and carefully examined for any "red-flag" items such as missing check numbers. Checks should be issued to legitimate payees, and mailed to verified business addresses. Employees should not be allowed to take possession of checks to third parties. Signatures, and signature signing authority, should be checked.
- Require all checks above a nominal amount to have two signatures. Never sign a blank check. Sign every payroll check personally. Avoid using a signature stamp.
- Small business owners should take the time to review accounts payable by checking cash disbursements and payments. A very common scheme to look out for is billing-scheme fraud where an employee sets up fictitious "phantom" vendors. Ask about each vendor and make sure you know who they are.
- Be alert to disgruntled or stressed employees, or those who have indicated that they are having financial difficulties.

Employee Support Programs. Many progressive companies and agencies have realized the benefit of employee support programs. Some kinds of support programs include alcohol and drug assistance, and counseling for gambling, marital problems, and financial difficulties.

EXAMPLE: The controller of a small fruit-packing company in California stole \$112,000 from the company. When asked why, he said, "Nobody at the company ever talked to me, especially the owners. They were unfair. They talked down to me, and they were rude. They deserved everything they got."

4. *Whistle Blower Policies.* Every company should have in place a way to report suspected employee theft. Generally this can be as simple as a box outside the owner's office where employees can leave letters or documents for the employer. Company policy should clearly state an employee can come forward and provide information anonymously and without fear of recrimination for good-faith reporting. The policy should also allow the report to be made to anyone in management, and not be limited to the employee's immediate supervisor.

5. *Insuring Against Dishonesty.* Many organizations carry insurance policies against fraud. These policies, sometimes called fidelity bonds, indemnify the holder against employees who dishonestly (1) commit fraud for personal benefit, or (2) cause the insured to sustain a loss. Everything from routine theft and embezzlement to commercial bribery and stock fraud is covered. The burden is on the insured, though, to show that an act of fraud caused the losses claimed. Companies cannot be reimbursed for unexplained inventory losses or pilfered cash accounts without a suspect, and facts supporting the existence and amount of the loss.

Most fraud insurance includes subrogation provisions, which state that if the insurance company pays a claim, it will acquire the rights of the insured to sue the wrongdoer. Policyholders are forbidden to interfere with the company's right to sue in any way. No settlement agreements or releases can be made with a dishonest employee unless the insurance company consents.

The insurance company's civil suit may seek to recover the losses under its policy, plus any uninsured losses suffered by the victim in excess of the policy limits. The recovered losses over the policy amount are paid to the policyholder.

6. *Investigate Every Incident.* A thorough and prompt investigation of policy and procedure violations, allegations of fraud, or warning signs of fraud will provide the facts needed to make informed decisions and reduce losses.

How to Conduct An Investigation

The first step is always to form a plan. Many times an employer learns of an employee theft and charges ahead without determining what needs to be done to preserve evidence. However, taking just a few moments to outline what information is required, how to obtain it, how to document what has occurred and to form a plan of action will go a long way in aiding the employer in recovery of stolen goods or money.

1. *Do Not Immediately Advise the Employee That There Is An Investigation.* If an employee knows he or she is under investigation, the employee can start destroying evidence, moving money around and concealing the crime. It is a much better approach to begin gathering evidence before alerting the employee or taking action against him or her.
2. *Consider hiring a private investigator.* Many private investigators have experience in conducting a workplace investigation. Employers can use them to advise on how to proceed and gather evidence or they can actually interview employees and gather evidence.
3. *Contact the Police.* Most cities have a fraud and theft division and will have an officer walk through what evidence needs to be gathered.
4. *Create A List of Questions.* It is always a good idea to outline what needs to be proven so that the person conducting interviews or gathering evidence covers all points. Often times, the employer does not have sufficient information to create a complete list of questions. Start by creating a list of known facts and ask questions about those facts.

For example:

- Who is responsible for ordering?
- How does the ordering take place?
- Who receives an order?
- Who books the payment?

Many times employers believe they know their systems, but it is good practice to review the established procedures. In most theft situations it is discovered that protocol was not followed.

5. *Interview Co-Workers.* The best sources of information often are the people who work together and see one another day after day. Over time, they learn what constitutes "normal" behavior in co-workers and can spot abnormal behavior within minutes. So when a theft occurs, employees are often privy to impressions as well as information about others on staff that no background investigation could ever reveal.

However, employees are frequently concerned that by providing information to investigators, they may be labeled as "snitches" or subjected to retaliation. Employees need to be told two important things when conducting an investigation: they will not be fired for being honest about what they know and that the future of the company (and hence their employment) depends upon their honesty. Never promise an employee that he or she will not be terminated for involvement in dishonesty or criminal conduct. Rather it is important to emphasize that an employee will not be retaliated against for being truthful. If employees ask if they could lose their jobs, it is important to state that it depends on their involvement in the conduct, but that dishonesty during the investigation will be grounds for termination.

An employee will provide information about a workplace theft only if his or her loyalty to the employer, and interest in protecting the employer's interests, exceeds the employee's loyalty to the guilty co-worker. It is easy for employees to feel loyal to someone they work with daily, especially if that person has become a friend. Therefore, it is important for the company to consider who conducts interviews the employee. Sometimes a trusted manager with whom employees have regular interactions will elicit more information than an outside investigator.

6. *Gather Documents.* It is important to preserve all possible evidence when conducting an investigation. If an employee is suspected of stealing, IT should be engaged to copy the employee's hard drive, and download and preserve e-mails. Copies should be made of all documents related to an employee's job, including time cards, punch records, data access records of when employees come and go, and video surveillance of the premises. If an employee has a social networking page, all pages should be printed out immediately, as this information may be lost if not immediately gathered.
7. *Contact Legal Counsel.* Before taking any action regarding disciplinary action, suspension or termination, consult legal counsel. There are certain considerations regarding recovery of the goods or monies that were stolen, which may be jeopardized if the employee is terminated. In addition, even if the facts support termination, the overly-broad communication of those facts or the manner in which the termination is conducted can create the risk of liability for discrimination, invasion of privacy, defamation, or intentional torts.

Can You Recover What Was Stolen

The most common legal question presented by workplace theft is "Can the money or items be recovered?" Many times the answer is yes, if the employer acts properly to investigate, document evidence, and involve legal counsel early.

If counsel is engaged early on in the investigation, they can seek court orders to freeze an employee's assets and have property returned. Such court actions can be commenced prior to or contemporaneously with the employee being terminated.

EXAMPLE: Employee was notified that she was being terminated for stealing through falsification of expense reimbursements. She was confronted with documents evidencing returns to her credit card for merchandise that was never purchased. The police were then brought into the room and the employee was asked if she wanted to make a statement, at which time she confessed much of her wrongdoing. The next morning the employer went to court and obtained an order freezing the employee's assets. Through a detailed investigation prior to termination and prompt assistance of legal counsel, the employer was able to recover almost all of the six figure theft.

Monies and stolen property can also be recovered through a criminal action. A properly prepared investigation can be presented directly to the District Attorney's Office, and when the employee is arrested and undergoing criminal prosecution, he or she will often be offered a significantly reduced jail sentence if restitution is made. With the increasing demands on district attorneys' offices it can often be difficult to obtain their involvement in complaints for non-violent crimes such as employee theft. However, a properly prepared and documented investigation that can be handed over to the authorities greatly increases the likelihood of a criminal prosecution. Many employees, when faced with prison, will find the means to make financial restitution, including borrowing from family members.

Other Sources of Information

Small Business Fraud Prevention Manual

Available from the Association of Certified Fraud Examiners (ACFE), this manual "provides information on the most common internal and external fraud schemes committed by customers, employees and vendors against small businesses as well as tips on how to prevent these schemes from happening to you."

For more information, please contact:

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