

How to Prevent Employee Fraud

Employee fraud—when an employee knowingly lies to, steals from or deceives their employer to make personal gains—occurs frequently among Canadian businesses.

In fact, 80% of employers reported being victimized by employee fraud, according to a study by professional services organization Ernst & Young.

Worse yet, small businesses tend to face a higher risk of employee fraud than large corporations. This is often due to a lack of basic accounting controls and a higher degree of misplaced or assumed trust.

While employee fraud can take place in many forms, the following are the most common types:

- **Asset misappropriation**—This type of fraud accounts for the vast majority of fraud schemes and includes cheque forgery, theft of money, inventory theft, payroll fraud and theft of services.
- **Bribery and corruption**—These methods include kickbacks, shell company schemes, bribes to influence decision-making, manipulation of contracts or substitution of inferior goods.
- **Financial statement fraud**—This type of fraud is the rarest and costliest. It entails manipulating financial statements to create financial gains for an individual or entity.

EMPLOYEE FRAUD INDICATIONS

It can be difficult for employers to spot employee fraud. However, 50% of employees who stole from their work showed prior behavioural red flags, according to a study by the Association of Certified Fraud Examiners. Therefore, it's important for small businesses to be able to identify employee behaviour and other signs that may be indicative of fraud occurring within the organization. Employers should look out for the following:

- **An employee living beyond their means**—If an employee's lifestyle suddenly doesn't match their salary, this could indicate fraud.
- **An employee working longer hours than usual**—Coming in early, staying late, working on weekends, or not taking sick leave or annual paid time off could be signs of employee fraud. Fraudsters often avoid taking time off because they don't want people to review their work. In addition, fraudulent activities often occur outside of regular business hours, when the employee is less likely to get caught.
- **An employee experiencing financial difficulties or family issues**—An employee who is going through financial problems or experiencing family issues might be more inclined to commit fraud to lessen their stress.
- **An employee being secretive**—If an employee is reluctant to share their processes or have someone review their work, they may be committing employee fraud.
- **An employee who works in a position to commit fraud**—Oftentimes, employees who have worked at a business the longest are the most likely to commit fraud. This could be because they have more trust, know the company's weaknesses or can control what appears on paper.
- **Accounts receivable that are suspicious or inconsistent**—Excessive or unexplained cash transactions, unreconciled bank account statements, sudden activity in previously inactive accounts, or an unusual increase in expenses, supplies or employee reimbursements can all be indicative of employee fraud.

By knowing employee fraud indications, small businesses can help limit their risk of exposure. Although it is helpful to know the signs of employee fraud, it can still occur so it's important to know how to limit the overall risk.



STRATEGIES TO PREVENT EMPLOYEE FRAUD

Employee fraud can be particularly devastating for small businesses, as they often have fewer resources available to help them recover from malicious acts. As such, it's important for small businesses to take the following action to prevent employee fraud:

- **Create a tip hotline.** Whistleblower tips are the most common way employee fraud is discovered. Therefore, employers should take tips seriously and set up a hotline to catch fraud earlier and minimize losses.
- **Conduct internal audits.** Conducting regular audits may not only allow employers to discover any misconduct but also deter employees from committing fraud in the first place.
- **Perform background checks.** Contacting references, performing background checks and conducting online research can help small businesses vet candidates before hiring them.
- **Implement internal controls.** While employees need a certain level of trust and authority to do their jobs, internal controls can help detect and hopefully deter fraudulent activities. Such controls can include clearly defining what constitutes fraud in the employee handbook, setting up an anonymous hotline and performing monthly bank reconciliations.
- **Create a culture of integrity.** Consistent controls and policies can create a culture that empowers staff to be accountable for their actions and minimize risk while driving compliance.
- **Purchase insurance.** Insurance, particularly commercial crime insurance, can help small businesses protect themselves from business-related financial losses.

By taking precautions and implementing internal controls, small businesses can effectively limit their risk of employee fraud.

If you have questions specific to your business, or would like additional information, please reach out to your Lloyd Sadd Advisor.

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