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# Employee Embezzlement in Times of COVID-19

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By **Heather Wilson** | December 22, 2020 at 11:43 AM

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At the onset of the pandemic nine months ago, no one believed we would still be here at the end of 2020. With the second surge of cases now spiking and economic pressures mounting on people and businesses, business owners should anticipate a potential increase in employee embezzlement. It is a preventable, but all-too-common, occurrence in times of financial stress.

## Financial Stress Resulting From COVID

The pandemic has had a major impact on the U.S. economy and its workforce. In response, businesses are tightening their financial belts by reducing employee compensation and overall staffing levels. Between April and September, the U.S. unemployment rate ranged from a low of 7.9% to a high of 14.7%, according to the U.S. Bureau of Labor Statistics. These layoffs have occurred across the board, from multibillion dollar companies such as Walt Disney, Boeing and ExxonMobil, to smaller businesses including professional services firms and many mom and pop shops. This crisis has triggered tremendous financial stress on a large portion of the population.

## COVID and the Fraud Triangle

The fraud triangle was developed by Donald R. Cressey, a leading sociologist specializing in criminology. Cressey's fraud triangle outlines three elements comprising the ideal environment in which individuals may be induced to commit fraud: opportunity, rationalization and pressure. Opportunity is the circumstance that allows the fraud to occur, rationalization is the justification for committing the fraud, and pressure is the motivation or incentive to commit the fraud.

The COVID-19 pandemic, and the resulting financial burdens on the population, provide the pressure and rationalization elements of the triangle. Pressure can emerge when individuals experience difficulties in providing for their families or in meeting daily financial obligations. This pressure can cause employees to take extreme measures they probably would never even consider in normal times, including embezzlement from their employer.

Rationalization occurs in the mind of the fraudster and can stem from this pressure. It provides the fraudster with a justification for committing the crime. Rationalization is often based on external factors, including the need to take care of a family, which fraudsters see as minimizing the harm done by the crime. Therefore, as long as the opportunity exists, businesses should expect an increase in employee embezzlement schemes.

Pressure and rationalization are driven and controlled by employees. While it is difficult for employers to address these elements in the work environment, they do have the ability to influence the third element of the fraud triangle—opportunity.

## Reducing Opportunity

Each year, a typical business is estimated to lose 5% of its revenues due to fraud-related activities, see Association of Certified Fraud Examiners Report to the Nations—2020 Global Study on Occupational Fraud and Abuse (ACFE Fraud Report). The most common type of fraud experienced by these entities is asset misappropriation, which represents 86% of all frauds, with an average median loss of $100,000. This type of loss can devastate a small business or nonprofit entity.

Small businesses and nonprofits are particularly susceptible to asset misappropriation schemes, mainly because they lack the necessary resources to implement and monitor an internal control program. Additionally, these entities tend to have long-term “trusted employees.” These trusted employees, particularly in the bookkeeping/accounting function, are handed the proverbial keys to the castle. Far too often, a sole employee will have responsibility for maintaining the general ledger, writing checks, reconciling bank accounts, managing accounts receivable and payable functions, and processing employee payroll, among other duties. This is temptation waiting to happen.

## Check and Payment Tampering

One of the most frequently committed and high-risk employee embezzlement schemes is check and payment tampering. These schemes involve an employee who steals company funds by intercepting, forging or altering a check or payment drawn on an organization's bank account. Check and payment tampering schemes have the highest median loss per incident at $110,000, with a median duration of two years, the longest of any asset fraud scheme category.

There are four major types of check and payment tampering schemes:

- **Forged Maker—**A scheme involving an employee forging an authorized signature on a company check. The employee can make the check out in any amount and to any payee including the perpetrator, an accomplice, or even to CASH.
- **Forged Endorsement—**A scheme occurring when an employee intercepts an outbound check intended for a third party and endorses the check as that third party. The employee then converts the check to cash by signing it over to themselves, an accomplice, or cashing the check at a location with little or no fraud prevention (such as a check cashing agency).
- **Altered Payee—**A scheme similar to the forged endorsement, but the employee changes the payee and inserts their own name or that of an accomplice in order to convert the check to cash.
- **Authorized Maker—**A scheme in which an employee, as an authorized check signor, writes and signs checks to herself or an accomplice. These checks can then be cashed at any banking institution.

## Controls

How do you reduce the opportunity element of the fraud triangle to prevent your company, or your client’s, from becoming a victim? Controls, controls, controls!

Even small businesses and nonprofits with limited resources can institute effective control measures to reduce the opportunity for employee embezzlement. Having well-documented processes and internal controls that are known and followed by all employees is essential. Ongoing communication with your employees regarding these procedures reinforces that management takes the issue of control seriously and considers it a top priority.

The following is a list of steps to help reduce the risk of becoming a victim organization:

- **Segregation of Duties—**This is the most basic and effective control measure to help prevent fraudulent activity. The entity should assign critical accounting functions to more than one individual, so that no single employee has control over an entire transaction. When possible, you should separate the initiation, approval, recording, and reconciliation of the transaction. Ensuring at least two people are responsible for this chain of duties makes it much more difficult to commit fraud.
- **Rotation of Duties—**The more employees become experienced, familiar and comfortable with their roles, the more they are able to recognize any weaknesses in internal controls and can attempt to exploit them. Although rotating duties is ideal, it is harder to accomplish in smaller entities.
- **Bank statement reconciliations—**Monthly reconciliations and review of bank statements and cancelled checks should be completed by someone not involved in the check preparation process. Many banks do not automatically provide cancelled checks with monthly statements; however it is an essential review step in preventing fraud. Most banks offer online account services where you can review cancelled checks for a certain number of months. Additionally, for a minimal fee, banks will provide copies of the front and backs of your cancelled checks with your monthly bank statement. An employee outside of the check preparation process should

be able to identify any suspicious items. Special care should be taken to ensure the following:

    - Authorized signatures are on each check.
    - Amounts and payee on checks not altered.
    - No checks were endorsed by the payee and signed over to employee.
    - No checks are made out to employees other than from payroll or expense accounts.
    - Amounts and payee match that of the cash disbursement journal.

- **Secure Records—**Accounts payable payees and addresses should be closely monitored. Access rights to add, delete or make changes to the vendor list should be limited, and any and all changes should be verified and approved by management.
- **Secure Checks—**All signed checks should be immediately mailed to the intended recipient; all blank check stock should be kept in a secure location. Additionally, do not sign blank check stock in advance of a scheduled vacation.
- **Surprise Audits—**In addition to monthly bank statement reviews and reconciliations, periodic surprise audits by internal accounting or an outside audit firm should be performed, if possible.
- **Mandatory Vacation—**In addition to job rotation, employers should require employees to use their vacation time. Knowing that someone else will be performing their duties will deter the employee from check tampering, as well as other fraud schemes.

While these steps help to reduce the risk of becoming a victim organization, employers must monitor these activities and evaluate them on an ongoing basis to ensure their functionality.

Additionally, entities should consider a commercial crime insurance policy including employee dishonesty coverage. In the event an employee embezzlement occurs, this type of policy can provide coverage for the theft of money, securities, or property, and can be written with a per-loss, per-employee, or per-position limit.

In the event that check tampering or any other type of fraud is suspected, it is best to act fast. Delaying could give the perpetrator time to cover their tracks and make investigations much more difficult and costly. Engaging a forensic accountant early in the process can assist with the investigation, identification, quantification, and potential limitation of losses attributable to a fraud scheme. In the unfortunate event that you become a victim, a forensic accountant can assist with the preparation of the loss claim for insurance purposes. Additionally, forensic accountants can identify potential control deficiencies that exist within an organization and develop policies to help protect against future frauds.

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