

EMBEZZLEMENT AND FRAUD: PROTECT YOUR PRACTICE

Inadequate internal controls can cause medical practices a great disservice.

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Legal issues abound in aesthetics, yet the problems of theft and embezzlement are often overlooked—and undetected. Targets of general employee theft range from office supplies to skin care products, but occupational fraud can be a more significant problem. The Association of Certified Fraud Examiners (ACFE) in a recent report estimates that a typical organization loses five percent of its revenues to fraud each year, translating to a potential projected global fraud loss of more than \$3.5 trillion. In addition, because fraud can be concealed for so long, the median duration of fraud at a medical practice is 18 months before detection.¹ And it happens a lot more often than you would think: the Medical Group Management Association found that of 945 practices, 83 percent reported being affiliated with a medical practice that had been the victim of employee theft or embezzlement.²

BREAK THE DISHONESTY CHAIN

Most employees who commit occupational fraud are first-time offenders with clean employment histories; the ACFE found that 87 percent of occupational fraudsters had never been charged or convicted of a fraud-related offense.¹ What's arguably worse is that 84 percent had never been punished or terminated by an employer for fraud-related conduct.¹ As physicians, we have the right to protect our property, just as we protect our patients. We can take a stand, but only with the right tools in place.

Determining why dishonest employees act the way they do is the first step in understanding and eliminating potential loopholes. The fraud triangle, known as Cressey's Fraud Triangle, helps model the factors that cause an employee to commit occupational fraud. Its three components lead to fraudulent behavior: perceived opportunity, perceived financial need, and rationalization (Figure 1).^{3,4}

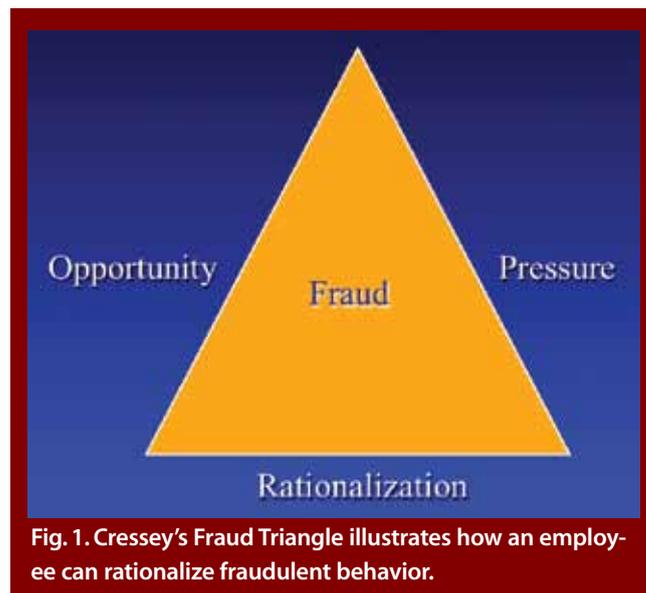


Fig. 1. Cressey's Fraud Triangle illustrates how an employee can rationalize fraudulent behavior.

Opportunity is the first and most important element in the triangle. You can effectively deter employee dishonesty by putting policies, procedures, and processes in place that reduce opportunities for fraud. Deputize only a few trusted individuals to handle financial matters and deal with billing, collections, and banking. Especially in smaller practices, there is a tendency to cross-train employees to complete various tasks so that team members can "step in" if another individual is ill or on vacation. Financials are not something you cross-train.

In the same vein, passwords for all financial systems, accounts, etc., should be known only by the few individuals that need to know them, and always by the principals in the practice. If you allow staff members to set their own passwords, be sure there is an override that principals can use at any time. I prefer to do my own online banking, which takes minutes to do; I am the only person with the username and password.

For material items, like office supplies, dispensed skin care, and especially medical products, be sure to have strict inventory controls in place. Current in-stock inventory should be checked against orders received and units sold on a regular basis. Medical and high-priced products should be stored under lock and key with restricted access.

RED FLAGS

In 81 percent of cases, the fraudster displayed one or more behavioral red flags:

- Living beyond means (36 percent of cases)
- Financial difficulties (27 percent)
- Unusually close association with vendors or customers (19 percent)
- Excessive control issues (18 percent)

—ACFE 2012 Report to the Nations. <http://www.acfe.com/rtn.aspx>

Some individuals steal because they can, but most employees embezzle because they are under financial strain. Pressure to steal can come in various forms. Employees may have bad credit or extensive bills or they may live beyond their means or face foreclosure. This pressure may lead to embezzling. As an employer, you have no responsibility to track a worker's personal financial situation, but as a savvy business person, you may at least keep an ear to the ground to spot individuals who may be facing pressure to find cash.

Rationalization is common among embezzlers, who adopt an attitude or thought process for moral justification. They may think, "They will never miss it" or "I am not stealing; I work hard and deserve it." Be attentive to employees who may convey this sort of attitude generally, because they may be translating that frame of mind to steal from the practice.

LOOK FOR THE SIGNS

Employees have embezzled thousands or millions of dollars from businesses, but that's typically over the span of several years. Embezzlement tends to start small. Petty cash and other small funds are a common first target. Employees may issue refunds to fake customers and then pocket the money. There may be an unusual drop in profit. Fraudulent employees may be found rewriting records for the sake of "neatness."

Physicians rarely want to get bogged down in the minutia of managing the petty cash drawer, but it is important to keep tabs on these things. At the very least, be sure that someone in your practice does reconcile all accounts—including the petty cash fund—and that you are alerted of any discrepancies that exist (a few cents or dollars won't matter, but anything over \$10 could be a sign of an employee "testing the waters"). You don't need to launch a major investigation the first time there is a discrepancy, but you should publicly address the shortfall to staff, so they know you are paying attention. By the second or third time you note a discrepancy, then more intensive investigation may be warranted.

Beware: dishonesty will not always be obvious. Watch out for "Sympathy Sally"—someone who always seems to have a death in the family, or repeatedly wants donations for a "cause." Fraudulent employees may be caught lying about

non-financial issues or never seem to want to take time off of work or vacation days, for fear of their secret being revealed.

CHECKS AND BALANCES

With nearly half of victimized organizations unable to recover their losses, proactive measures to prevent fraud are critical.¹ To protect yourself and your practice, consider creating procedures to help identify unethical and unprofessional conduct. Before hiring employees, verify their references and hold a background screening and credit check. I verify references and use an additional service from ADP, who runs our background checks. Once cleared, consider having employees sign a code of ethics or code of conduct before beginning employment, and require employees to take a one-week vacation every year. Take a zero-tolerance approach: "We prosecute employee theft." And follow through. In light of Cressey's Triangle, there's a chance that your thieving employee will have a ready excuse for their behavior, whether they be medical bills or imminent foreclosure. Even if you feel sympathetic toward the employee's plight, you cannot put your practice at risk by granting second chances.

Consider adding an umbrella policy to cover theft and embezzlement to your insurance coverage. Additionally, make sure your insurance policy specifically includes payroll theft (most do not)! In addition to providing a financial safety net, the policy provider may offer helpful resources to help you protect your practice.

Put in place effective controls. Review the books yourself at regular intervals and at random times, so employees never know when you may request reports. Also conduct periodic audits with auditors and forensic accountants. As suggested above, give employees separate responsibilities: those employees who order should not receive; an employee handling cash shouldn't manage the books.

Many practices have a no-refund policy, which reduces the likelihood for employees to hide theft as "refunds." If you do offer refunds, require sign-off from a senior staffer and have strict policies regarding acceptable reasons for return and handling of returned merchandise. Consider using a drop safe. If your practice has many rooms (or even if it doesn't), think about installing a video surveillance system, especially where monies are exchanged.

Among important inventory controls: keep a small stock. Carrying less inventory can help reduce theft. In addition to eliminating theft, small inventory helps avoid tying up cash with items that may or may not sell. Consider ordering more frequently but in smaller quantities, which will help allow for a better cash flow. Additionally, sitting on a wealth of fillers, implants, and products only makes tracking and the control of products

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more difficult.⁵ The more you have, the easier it is for a piece or two to go missing without detection.

Protection begins with you. It is important for physicians to be familiar with suppliers and exercise due diligence on bookkeeping. Require two signatures on each check, and review bank statements, in particular the checks issued. Above all, set a good example and stress business ethics.

UNCOVERING THE PROBLEM

If you unfortunately find yourself the victim of embezzlement, there is hope. However, while you may want to instinctively call the police or confront your employee, restrain at first. Employees may sense that you are on to their behavior and begin working to destroy their trail (i.e., receipts, computer files). Have a cash-paying secret shopper or patient complete a cash transaction if you suspect cash theft. If theft is indeed taking place, work to preserve the evidence before confronting your employee. Next, obtain professional advice instead of trying to investigate the situation yourself. Keep financial protocols the same; big changes may just tip off your employee.

Involving the police or an insurance company are also things to wait on: get sufficient evidence to confirm fraud first; and do not fire employees until the evidence is gathered. The cost of a wrongful termination lawsuit may be far more costly than the items or cash being stolen. Once substantial evidence is obtained, make a police report for the theft; the case will then be turned over to the Justice Department for prosecution. At that point, it is out of your hands.

CONCLUSION

The cost of occupational fraud to your practice—both financially and to your reputation—can be acutely damaging. Management should continually assess the practice's fraud risks and evaluate its prevention programs. Difficult economic times only add to the fraud triangle's power, so be sure to implement practice systems that can help protect you from becoming the next victim of fraud. ■

1. Association of Certified Fraud Examiners. 2012 Report to the Nations. <http://www.acfe.com/ttn.aspx>

2. Medical Group Management Association. MGMA Employee Theft and Embezzlement Research. <http://www.mgma.com/theft>

3. Cressey DR. Other People's Money. Montclair: Patterson Smith. 1973;30.

4. Wilson RA. Employee dishonesty: National survey of risk managers on crime. *Journal of Economic Crime Management*. 2004;2:1.

5. Jacoby D and Corvigno M. The Just-in-Time Model: Smart Inventory Management in Tough Economic Times. *Practical Dermatology*. June 2010;13-5.

DO THIS NOW

Consider having employees sign a code of ethics or code of conduct before beginning employment, and require employees to take a one-week vacation every year. Take a zero-tolerance approach: "We prosecute employee theft." And follow through.