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The Key To Educating Employees On The Effects Of Fraud

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Companies continue to lose a painful amount of money each year as a result of fraud in their own workplace. And, sadly, the evidence shows leaders do not take sufficient steps to protect their organizations from these often preventable losses. According to the Association of Certified Fraud Examiners' 2016 report to the Nations on Occupational Fraud and Abuse (ACFE report), the typical organization loses an amount equal to 5 percent of its annual revenues to fraud every year. Yet only 51.6 percent of companies included in the ACFE survey conducted fraud training for employees and even fewer had an anti-fraud policy.

Victim organizations that lacked such anti-fraud controls suffered median losses twice as large as those which had implemented such controls. The time to act is now.

As with any new initiative in the workplace, however, a company's dilemma is how best to persuade employees to take seriously the implementation of anti-fraud controls. The key is to help employees understand fraud's impact on their employer and, by extension, on them. Employees are much more likely to comply with an anti-fraud control plan if they realize its necessity.

To illustrate, assume Employer X, a finance company, institutes a policy that demands its employees power down their mobile phones upon setting foot in their work areas. Many employees will refuse to comply, instead choosing to subvert what they view to be a senseless policy, by silencing ringers or using their phones surreptitiously.

But Employer Y, a tech company reliant on its employees' work with expensive equipment highly sensitive to radio waves, should get a better result. Few employees would be willing to risk causing a catastrophic failure of a critical profit center over the use of a mobile phone. In fact, in such a workplace, employees would probably not question a policy prohibiting the mere possession of such mobile devices onsite.

Employer X's policy appears capricious and oppressive. The same policy instituted by Employer Y seems essential to the well-being of the enterprise. Under these circumstances, it is not difficult to understand why one set of employees will comply while the other set may revolt.

Students of law or philosophy may recognize the difference as a comparison of acts which are malum prohibitum and those which are malum in se. Conduct which is malum in se (evil in itself) — murder, rape, arson — is viewed by almost all members of society as loathsome and worthy of the strictest of condemnation. Conduct which is malum prohibitum (evil because prohibited), on the other hand, evokes no such strong moral response. Few people would view a motorist who parked his car for 40 minutes in a “30-minute maximum” zone or a lemonade stand operator who does not have a business license as depraved or dishonest.

Generally speaking, moral people will not engage in acts they believe to be malum in se. To underscore the point, if you ask a friend if he or she would commit a murder if the criminal penalty therefor was eliminated, I hope you would not expect an answer in the affirmative. If you would, you may want to find a new friend.

Conversely, people who would never steal so much as a cup of sugar from a neighbor will engage in all sorts of acts they view as merely malum prohibitum: watering the lawn during daylight hours during a drought; failing to pay the “use tax” on items purchased out of state; driving five miles per hour above the speed limit. Good people commit these prohibited acts all the time because they do not view them as wrong. Their willingness to comply with the law is affected only by the likelihood of and penalty for being caught weighed against the level of inconvenience compliance entails. In fact, some people bristle so much at the thought of such laws that they will violate them on principle alone.

Many factors affect a person’s determination of whether an act is immoral: historical treatment, religious teachings, and personal experience, for instance. The predominant factor people consider, however, is the amount of harm an act inflicts on other human beings. In the U.S. Department of Justice Bureau of Justice Statistics’ National Survey of Crime Severity (Marvin Wolfgang et al. 1985), over 60,000 participants rated the severity of 204 different crimes. Overwhelmingly, the crimes which caused the most harm to the most people were rated as the most severe; so-called “victimless crimes” such as public intoxication, vagrancy, bookmaking and underage drinking and truancy rated the lowest.

The National Survey of Crime Severity demonstrated that the end result of an act — the harm it caused — has much or more to do with its measure of “severity” as the nature of the act itself. For instance, in responding to three scenarios in which the act itself was identically described as “A man forcibly rapes a woman,” respondents rated a rape resulting in “physical injuries requir[ing] hospitalization” approximately 16 percent more serious than one causing no other physical injuries. A rape resulting in the victim’s death was rated about twice as severe as one causing no other physical injuries. Likewise, the planting of a bomb in a public building resulting in one death rated only about 60 percent as serious as one resulting in the death of 20 people.

The lesson to be applied to fraud prevention is that, assuming most of a company’s employees possess an ordinary sense of right and wrong, they will avoid behavior they believe to be immoral and will refrain from activities they view to be harmful to their co-workers and shareholders.

Under such assumptions, the goal of an employer in instituting an anti-fraud plan is to explain to and convince employees that tolerance for fraud in the workplace is wrong and harmful. The primary goal of such education efforts is not to convince someone predisposed to commit embezzlement not to do so; that sort of fraudster is unlikely to be deterred by moral reasoning.

Rather, the focus is on curbing smaller transgressions that many employees think of as causing trivial harm (at most) to the company — clocking in a co-worker a few minutes before he shows up at work, submitting a personal expense for reimbursement as a business expense, helping a vendor owned by one’s brother-in-law win a contract — through effective employee education. The key is to help employees understand that engaging in such activities is harmful and that reporting such misconduct of others is as important as refraining from it in the first instance.

How harmful is fraud to a company? To be sure, fraud does not cause harm as extreme or dramatic as the sexual assault or bombing examples posed in the National Survey of Crime Severity. But fraud losses may cost employees their jobs and, in many high-profile cases, fraud has resulted in the death of corporations and the loss of billions of dollars in shareholder value.

Each company faces unique fraud risks. Employee education on the importance of anti-fraud controls must therefore be tailored to match the specific fraud risks presented by the company's industry and the specific employees' roles. One general principle to which effective education messaging should adhere, however, is to emphasize the wide-sweeping effects of fraud. Here is an example of a generic introduction of the subject:

How would you be affected if 5 percent of our annual revenues walked out the door? Would your job still exist? Would you have gotten a raise last year? Could you reasonably expect opportunities for promotion or increased responsibility to be available to you?

For many businesses, that 5 percent can be the difference between large holiday bonuses and the consideration of downsizing; between a leap in stock price and a board of directors under fire. The typical organization loses that amount annually as a result of fraud.

Five percent is a much larger number than it sounds. Wal-Mart, for instance, reported net income of just over $15 billion for fiscal year 2015 on revenues of $482 billion. All else being equal, a 5 percent revenue reduction turns a $15 billion profit into a loss of around $9 billion.

The mathematics of fraud is harsh. In day-to-day business practice, a 5 percent reduction in revenue is typically accompanied by a large reduction in expenses as well. For instance, 5 percent of sales lost to a retailer results in decreased expenditure on all sorts of variable costs, such as inventory purchasing, labor, sales commissions, etc. The effect of such a conventional loss of revenue is affected by the company's profit margin.

But a company which loses that same amount of revenue as a result of fraud often receives no accompanying decrease in expenses; if a fraudster helps himself to a large sum of cash out of corporate coffers, the money leaves the company on a dollar-for-dollar basis. Depending on a company's margins, the effects of fraud are ten or more times more severe than a typical decrease in sales.

Fraudsters skim the cream off the top of the company's profits.

Employee education must focus on specific examples of fraud and why the vigilance of all employees is required to keep small frauds from occurring, small frauds from becoming larger frauds, and so on. A chain of auto parts stores, for example, may want to focus its efforts on helping store managers understand the perils of "creative invoicing" in service bays or "free" parts walking out the door in the hands of employees and their friends.

Regardless of the specific fraud risks, ensuring employees understand why anti-fraud controls are necessary is of paramount importance. Fostering that understanding is the key to the successful implementation of anti-fraud controls.

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