

# INTERNAL CONTROLS

## A Company's First Line of Defense Against Fraud

By **Rachael Austin**, *Muckel Anderson CPAs*

**W**hat does a convicted embezzler look like? He could look like your neighbor, or she could look like your mother-in-law. A white-collar criminal could be anyone, really. In fact, in case after case, fraudsters are respected, charismatic, and easy to trust.

Diann Cattani was that kind of person. Cattani was found guilty of embezzling more than \$500,000 over four years from a small human resources consulting firm in Atlanta. Cattani attended Brigham Young University on a volleyball scholarship. After graduating with honors and moving to Atlanta, she married and had two kids. So, how did this mom turn embezzler? It all started when a family vacation was accidentally charged to her company credit card. She planned to reimburse her employer, but when no one noticed, and no one asked her about it, she began using her company card to pay for other things. Greed took over. Eventually she increased her own salary and even set up a fake vendor to pay herself even more. "I became addicted to a certain lifestyle," says Cattani in the article "Returning to Where it All Began" by Dick Carozza in the September/October issue of *Fraud Magazine*. After serving 18 months in federal prison, Cattani now works at an accounting firm and occasionally lectures on fraud. "I'm probably your stereotypical white-collar criminal," she says in the piece "The Embezzler Next Door," by ABC's Michelle Goodman.

Given a tough economy that has financially stressed employers and employees, how can a company protect itself from fraud? Establishing strong internal controls is a company's first line of defense. Often management doesn't consider controls until after fraud has impacted the bottom line, but being proactive about creating a strong control environment is cheaper than prosecuting an embezzler! Ensure your company has sufficient internal controls in place by asking yourself a few questions:



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### Is cross-training part of your business model?

Sometimes fraud isn't discovered because personnel don't take time off from their schemes. In a lapping scheme, for example, an accounts receivable clerk pockets incoming payments from Customer No. 1, but applies a payment received from Customer No. 2 to Customer No. 1's account. Subsequent payments are continually used to cover the preceding stolen ones, so customers don't complain about

outstanding balances. The key to this crime is that the employee must always be in charge of receivables in order to perpetuate the cycle. Cross-training employees to fill different positions prevents this type of scheme (and others like it). Mandatory vacations aren't a bad idea, either.

### Are credit card holders held accountable?

Charging personal expenses to a company credit card is one of the most common ways employees steal. While most companies require card holders to submit receipts, sometimes the receipts aren't reviewed or compared against reimbursable expense reports previously submitted by the same employee. A card holder may be tempted to "double dip" by charging valid company expenses to their card, and then saving those same receipts to submit with an expense report for reimbursement.

Take a look at your company's credit card policy, and ensure the right person is reviewing the credit card statement. An accounting clerk probably won't question a manager's credit card charges, but the owner of the company might. In fact, an owner of a small business is probably the best control device there is, especially when there are few employees. In a small business, only an owner can create the perception of a strong control environment, even if it is just by opening and reviewing the credit card statement every month.

### Is a coworker living in the fast lane?

Gambling, luxury cars, and expensive hobbies are all signs that an employee may be embezzling. Don't ignore the obvious! If an employee's lifestyle is too good to be true, there may be a loophole in your control structure.

Start by analyzing the individual's position and who they report to. Autonomy with little oversight can be a dangerous combination. Tighten controls by implementing checks and balances or what accountants call, "segregation of duties." Basically, the idea is to separate key functions. Those tasks that involve collecting or paying money should be separate from recording and reporting those collections or payments. If an employee is responsible for billing, for example, have a different employee handle collecting and posting customer payments.

If you're a small business owner, you know that segregation of duties isn't always possible or cost effective. The key, then, becomes owner review. Creating the perception of strong controls starts at the top. Like the credit card statement, the bank statement should be opened first by someone who isn't writing the checks or collecting payments. In a small business, this is often the owner.

Fraud is a buzzword. It makes for interesting water cooler conversation and front page news stories, but until white collar crime impacts your business, you may not realize the importance of internal controls in the workplace. *Greed can be a strong force; make sure your controls are stronger!* Cattani cited an eye-opening KPMG Integrity Study in her March 2010 presentation at the University of Arkansas:

"Ten percent of people are morally impeccable and would never commit fraud, 10 percent of people are crooks who live to steal, and 80 percent can go either way. With personal financial challenges, a perceived opportunity to steal, and morally defensible excuses, the average person may commit fraud."

—From *the White House to a Prison Cell: Diann Cattani's Story*, Sam M. Walton College of Business Accounting Department.

If you're interested in evaluating or strengthening the internal controls at your company, call your certified public accountant (CPA) or certified fraud examiner (CFE).

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