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Certified Public Accountants/Business Consultants

Employee Fraud- Not in My Cemetery or Funeral Home! Think Again!

It wasn't until city officials, acting on a tip, hired a private detective to look into the actions of the superintendent of a large mid-western cemetery. They discovered that he was profiting from double selling gravesites, selling gravesites too narrow to hold vaults and using the organization's money to have repairs done to his personal equipment. Interviews with cemetery workers revealed that they suspected what was going on and in some cases had confronted him but feared for their jobs. Had they had a mechanism for reporting these crimes, the organization could have stopped the problem much earlier and avoided significant costs and loss of credibility in the local community.

Fraud is a Big Problem for Cemeteries and Funeral Homes of All Sizes

As a cemetery or funeral home owner, you'd like to believe that you're not susceptible to employee fraud and abuse. Because it's natural to trust people we've known and worked with for many years, none of us really thinks in terms of, "I have to watch Martha." Unfortunately, the Marthas of the world are more often than not the perpetrators.

Most small cemeteries and funeral homes start with family members or partners controlling the key positions. In these situations, an internal control system is not considered necessary. As the business grows and becomes more complex, outsiders are generally added to the mix. The day the first outsider is given a key to the office, you as the owner need to think about how you could be robbed and then design ways of doing business that protect your investment in the organization.

Research by the Association of Certified Fraud Examiners revealed that companies that employ 100 or fewer people are the most vulnerable to employee fraud, suffering a median loss of \$120,000. The impact of a six-figure embezzlement on a small business can be devastating. Assuming revenues of \$5 million and a 10 percent net profit, an organization must increase revenues by 20 percent to replace an embezzled \$100,000. Hardly easy chores in the highly competitive cemetery and funeral home industry. Of course, the impact on the remaining employees will be devastating when raises or bonuses are eliminated due to the fraud.

Unfortunately, the cemetery and funeral home industry has suffered from significant bad publicity during the last few years. Perhaps today, more than ever, promoting a positive public image is critical. Once a fraud finds its way to the press, customer confidence and public perception decline rapidly. You only need to think of the devastation to the image and revenue of the United Way Campaign after it was revealed that its president embezzled millions and used the money to support a lavish lifestyle.

Why Do Employees Commit Fraud?

What drives otherwise intelligent and decent people to violate the trust you give them? Joseph T. Wells, a noted fraud researcher and the chairman of the Association of Certified Fraud Examiners, in his book *Occupational Fraud and Abuse* points to human failings as the root cause. His studies of a diverse group of cases revealed a complex set of motives and opportunities contributing to the crimes. Wells notes that a triangle of environmental and psychological factors composed of "perceived financial need," "rationalization," and "perceived opportunity" must be present to permit an otherwise trustworthy employee to commit a fraud.

Satisfaction of a perceived financial need is the usual starting point in a fraud scheme. Examples of perceived need drawn from case studies include:

- A method to cure personal financial problems
- A means to satisfy marital problems caused by gambling, drugs and alcohol
- A way to meet unrealistic performance goals
- A method to earn bonuses or rewards from short-term goals
- A way to make up for perceived low pay when compared to salaries of others

Virtually every case of employee fraud involves the perpetrator concocting a rationale for committing the crime. A recent case handled by the forensic professionals at MKS&H involved the trusted controller of a small, local company. He came to the company with a strong résumé and good references. The owner was pleased to have this mature CPA help him run the three-person accounting department and assist with the financial aspects of the business. This individual began work in January, and by April had forged the owner's signature on over \$35,000 in checks written to himself. When we questioned the controller about his reasoning, he explained that he had heart problems and needed the money for his medical bills. He viewed the money as "excess" cash that the company should give him because he was not eligible for the company medical plan.

Some of the classic reasons offered by perpetrators include: "I didn't steal anything, I was only borrowing the money--I was going to pay it back." "They owe it to me, I make all the money for them and they don't share it." "Because of my position in the organization, I am entitled to the extra perks of the job; it's ultimately good for the company." "I wanted to prove that they were too stupid to catch me."

The opportunity to commit fraud is enhanced by organizational problems, such as failure to create an environment that supports ethical behavior and a code of conduct as well as the failure to punish offenders and publish punishment within the organization. Allowing ineffective fraud prevention and detection control procedures to remain in place creates significant opportunity. If you hire and promote on faith and gut feelings, you provide ample opportunity for the fraudster to move into positions of trust that can be violated.

What Does Employee Fraud Look Like?

Rarely will you see employee fraud at first hand. Frequently, it is difficult to determine whether it has actually occurred until a catastrophic or embarrassing event occurs in the cemetery or funeral home. However, there are clues or symptoms that cemetery and funeral home owners should train themselves to recognize. While not a complete list, following are several of the major indicators that owners and managers should consider.

Employee Behavioral Symptoms

- Changes in lifestyle. Nobody who steals saves the cash.
- Changes in behavior. Nice people become belligerent and vice versa.
- Refusal to take vacations. Schemes require constant attention.
- Reluctance to delegate tasks even when obviously overworked
- Discussion of personal financial problems
- Onset of alcohol or drug problems of the employee or his family

Company Operations Symptoms

- Employees are hired without a thorough background investigation
- Internal control procedures are ineffective or ignored
- Management oversight of critical procedures is lax
- Conflicts of interest exist with owners and managers
- Lack of an effective code of conduct and employee fraud education program
- Absentee ownership

Company Accounting Symptoms

- Financial Statements often contain errors
- Frequent complaints from customers about billing errors
- Excessive number of adjusting entries with vague explanations
- Frequent complaints from vendors about late payments
- Excessive number of missing invoices
- Inability to reconcile subsidiary ledgers to the general ledger
- Unexplained decrease in profits or cash flow

Fraud Exposure in the Death Care Industry

It's often said that "cash is king" and that is certainly true in the typical employee fraud. Common schemes to liberate cash from cemeteries and funeral homes include:

Salesforce embezzlement

- Bogus contracts created to collect a front-end commission
- Cash received from preneed sales diverted to the salesperson's pocket
- Monthly payments made directly to salesperson on contracts never recorded on company books
- Phony payment vouchers that direct payment to the salesperson's bank account

Management and office employee embezzlements

- "Skimming" payments on account. Typically, an employee records a contract at a lower amount than actually owed then steals or "skims" the excess.
- Falsifying customer statements. This is done to avoid past due notices when the employee has stolen the customer's payments.
- "Forcing" balances. In this scheme, cash is stolen but the payment is posted to the account. The employee alters the books to cover the theft.
- Check tampering. Employees will forge signatures, alter the payee and increase the amount of the check.
- Check forgery. The advent of high quality scanning equipment has made it very easy to reproduce exact duplicates of checks and signatures with altered payees.
- Kickbacks and bribery schemes
- Cash disbursement schemes
- "Ghost" employees on the payroll

Combating Employee Fraud

Fraud will probably never be eliminated in the workplace, and it is especially challenging for small cemeteries and funeral homes that must balance the cost of controls with the risk of embezzlement. The organization must seek a balance between trusting its employees too much and too little.

Unlike common street crime, it is possible to prevent much of the fraud that occurs in your organization. Criminologists who have studied these issues note that street criminals frequently act with little forethought. However, the fraud offender will carefully weigh the risks and rewards of the crime. Because of this, it is possible for you to create a fraud prevention program that promotes honest behavior. While not exhaustive, implementing the following suggestions will help your organization prevent fraud.

1. Establish an Atmosphere of Ethical Behavior

The typical reaction to the discovery of a fraud in a cemetery or funeral home is to treat it as an isolated occurrence. Sadly, the conditions that enabled and even encouraged the crime remain in place. Death care industry leaders today are beginning to realize that without changes to ethical infrastructure, as well as the control systems, the organization will suffer more losses. Many experts in employee fraud agree that where you have fraud, you probably have an ethics problem. Research shows that employees who view their leaders as honest tend to emulate them.

Regardless of the size of the cemetery or funeral home, a formal ethics policy is a good idea. Of course, you must practice what you preach. If employees see the owner fudging on taxes, lying to vendors about payment dates or paying personal debts out of corporate funds, the stage is set for problems.

The Association of Certified Fraud Examiners recommends three things to include in your policy. (1) Identify specific conduct, which violates the policy; (2) reinforce the fact that dishonesty will be punished; and (3) explain the method for reporting unethical conduct observed.

2. Create an Employee Education Program

Unfortunately, many accountants and auditors consider extensive internal control procedures to be the solution for fraud prevention. Since known losses from employee fraud now exceed \$400 billion a year and continue to grow, something is missing. Clearly strong controls are only part of the solution.

Fraud is a crime shrouded in shades of gray, which often becomes clear only after a devastating loss. Because of its ambiguous nature, the majority of employees must be in favor of and participate in a proactive fraud prevention program if it is to be successful.

The message must be clear--Our cemetery/funeral home takes fraud seriously and it will not be tolerated, at any level in the organization. Employee education should focus on the costs to the organization including: lost raises, reduced benefits, job losses, personal morality and integrity.

3. Establish a Fraud and Abuse Reporting Program

Employees who are suspicious that fraud is occurring must have a mechanism to report it. A hotline is considered by most professionals to be the cornerstone of an employee-reporting program. In addition to providing a venue for anonymous communication, it works to increase the perception of detection. An employee who is aware that his illegal and unethical activities might be reported by a coworker will be less likely to engage in such conduct. Small cemeteries and funeral homes can utilize the services of a 24-hour hotline for less than \$500 per year.

4. Create an Effective Deterrence Strategy

Critical to the deterrence of fraud and abuse is the perception in the employee's mind. Employees who perceive that they will be caught are less likely to commit fraud and abuse. Internal controls have a deterrent effect when the employee perceives that the control is in place to uncover fraud.

A functioning internal control system is critical to preventing employee fraud. Some basic control procedures that an organization in the death care industry should have in place include:

- Use pre-numbered sales contracts.
- Maintain positive control of all contracts.
- Require sales staff to account for every contract issued to them on a weekly basis.
- Limit sales commissions paid to amounts collected.
- After mandatory cooling-off periods, require non-sales staff to contact customers to verify the sale.
- Investigate complaints from customers who receive late notices.
- Require written documentation of write-off of receivables.
- Require certificates of ownership, deeds, interment service order forms, lot owner cards, interment cards and burial cards to be pre-numbered and under positive control at all times.
- Maintain cross-referencing among documents by use of a control number.

Death care provider organizations with only a few employees can, in addition to the above controls, establish other basic controls:

- As much as possible, segregate duties and responsibilities. Whenever one person has the authority over an entire transaction, the risk is high that fraud can occur.
- Have your bank account statements delivered to the owner unopened each month.
- Rotate assignments. Many schemes require constant attention to the fraud. Rotation will disrupt the fraud.
- Obtain fidelity bonding. Insurance will help limit the loss and may function as a deterrent.
- Control your new vendor additions. Phony vendors are one of the most common fraud schemes.
- Control changes to the payroll. The common use of outside payroll services makes it easy to create "ghost" employees.

These suggestions are not intended to be a complete fraud prevention plan. Rather they are designed to stimulate your thinking about what might be occurring in your cemetery or funeral home. I encourage you to take a step back and evaluate your operation. There may be nothing happening; however, you will never know unless you have a look.

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