CONTRACTOR’S BUSINESS MANAGEMENT REPORT

Contractors Beware: Employee Fraud Cuts Profits

Richard Gavin
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Contractors must be vigilant about the risks of fraud by even their most trusted employees, writes Richard Gavin, CPA, partner, Grassi & Co. (Lake Success, N.Y.) in New York Construction (McGraw-Hill; www.construction.com).

In construction companies, the median loss due to employee fraud is $145,000 per incident, according to the 2004 Report to the Nation on Occupational Fraud and Abuse published by the Association of Certified Fraud Examiners (Austin; www.acfe.org). Clearly, construction firms with already thin margins can ill-afford the cost of even one dishonest employee.

Gavin points to classic fraud schemes that contractors should be aware of:

- A project manager sets up a fake company with a name similar to one of the contractor’s primary vendors, then creates false invoices and pays the fake company.
- A bookkeeper approves the invoice for payment and signature-stamps the checks.

Erecting the first line of defense against employee fraud. The most cost-effective way to address fraud is through prevention. According to the ACFE Report to the Nation, once an organization has been defrauded, it is unlikely to recoup its losses. Among the cases ACFE studied, the median recovery was only 20% of the original loss, and almost 40% of victimized organizations recovered nothing at all.

In general, employee background checking is a good first step toward preventing fraud. However, there are some limitations you should be familiar with. For example, in interviews with National Public Radio (www.npr.org), several experts cited errors they are seeing companies make:

1. Conducting cursory checks. Experts estimate that 7% of job applicants hide
criminal backgrounds from prospective employers. But, according to Craig Kessler, CEO of www.backgroundchecks.com, an online employee investigations firm (Irving, Texas), these applicants are very clever. They know that many companies only conduct a criminal conviction check in a single county, usually the employer's location, so they simply cross state lines when looking for work. "Plain and simple, they know the game," he notes.

Best practice: Companies should consider asking for expanded services when hiring a firm to conduct checks, Kessler suggests. CBMR agrees: If your company thinks it is important to know about the possible criminal past of a job applicant, dig deep enough to find out if such a record truly exists.

Best practice: Conduct a residential history for an applicant for the past seven years, and conduct criminal checks in all the counties in which he or she lived.

2. Forgetting foreign workers. Many companies investigate prospective employees with foreign backgrounds less than they check on domestic workers. Background records for foreign workers are more difficult to obtain, are more expensive, and vary by country. Subsequently, many companies don't dig deep enough into the backgrounds of workers when non-English speaking countries are involved.

Best practice: If your company's risk assessment concludes that certain record checks are important, you should conduct them regardless of their difficulty to obtain. While it's smart to adjust the extent of background checking depending on the sensitivity of the position you're filling, it's a bad idea to adjust it because of the difficulty or expense of obtaining the information.

3. Ignoring the legal pitfalls. Various local, state, and federal laws limit your right to obtain and use information for screening job applicants.

Best practice: Companies should match their interest in knowing more about job applicants with employees' rights to privacy. According to Focus on Corporate Security (Bureau of National Affairs, Inc., Washington, D.C.; www.bna.com), the basic precautions you can take to reduce the potential for legal problems include:

- Inform applicants in advance of any background checks, secure their written consent to initiate the verification process, and make a full disclosure of the information you're gathering and your purpose for requesting it.
- Limit inquiries to verifiable job-related information, and ask the same questions to each prospective job candidate for a position. Avoid questions that state guidelines or federal law consider improper.
- Check the accuracy of information with other sources before using it to reject an applicant. Make sure your company has a proven business-related reason for using the information to reject the applicant. Give applicants sufficient time to contest negative information.
- Ensure that background information is weighed in the same way for all candidates for a particular position.
- Make sure that any references that you contact are familiar with the candidate and in a position to provide relevant, job-related information.

4. Failing to tailor checks to the job. Companies that are expanding or initiating background checks will probably be pleased to see that a detailed screening that would
have cost $300 years ago will now cost only about $50. But even if the checks are more affordable than in the past, companies can still waste money conducting boilerplate background checks for every employee—something they can’t afford in the current economic climate.

Best practice: Make the background check appropriate to the job, advises Gary Cornick, president of screening firm PeopleWise (Miamisburg, Ohio; www.peoplewise.com). What exactly does that mean? Consider the job requirements when selecting how many different records you need to check. For example, will the employee be operating a vehicle on behalf of the company? Will the employee be handling money?

For more details: The 2004 Report to the Nation on Occupational Fraud and Abuse can be downloaded at www.acfe.org.

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"Dashboards"
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Still, dashboards have their detractors, some of whom say a “picture may be worth a thousand words, but in what language?” These individuals question whether it is too much to expect a “visual” to explain your DSO in a meaningful way or your healthcare expenses in a manner that could help you make smarter strategic decisions.

William P. Erfourth, business advisory principal, Grant Thornton, LLP (Southfield, Mich.), and Danny B. Parrish, president, Parrish Consulting (McKinney, Texas), offered CFMA attendees an overview of a dashboard, its uses, and the importance of key performance indicators (KPIs).

What is a dashboard? A dashboard is a portal to data stored electronically within your company’s business units that can help you assess performance—by department, function, or individual. Typically, a dashboard resides on top of your business process management system as the “front-end display of key metrics.” Upshot: At a glance, you can grasp what is happening in your company, be warned of emerging challenges, and respond swiftly.

Recalling the day when executives got critical information from so-called Flash Reports twice a month, Erfourth suggested that dashboards, while serving the same function, get that critical information to managers sooner. “Dashboards, today, give a higher summary of data on a more current basis,” he added, “allowing management to focus time and resources where they need to be directed.” How? Dashboards “operate with pointers and filters to ensure delivery of data you need to look at rather than having to sift through a lot of other data.”

Plus: You can get this information on a real-time basis. That is, if an unfavorable incident occurs, its impact can be factored into the information immediately. In the construction industry, where time is money and managers often travel between job sites and the office, dashboards offer huge benefits.

Can dashboards help you make better decisions? Dashboards convey vital information to decisionmakers, with the objective to improve operational and financial performance and enable management to make decisions sooner rather than later (see the sidebar, "Types of Dashboards"). A dashboard is most efficient when its design factors in “management’s thought process”—that is, information deemed relevant for proper decisionmaking. Articulate your information needs to the IT person or designate creating the dashboard. Why? The dashboard designer will better understand how you presently