Embezzlement – Is your practice at risk?
Sherry Everhart BS, CVT & David McCormick, MS

Experts say embezzlement arrests are up 70% since the 1990s and that cases are prolific in small businesses like veterinary, dental, and other health care professions where often one or two employees have a broad range of control over the business’ assets. The actual loss that these businesses suffer is very difficult to determine as owners generally do not detect the problem until a significant amount of time has passed, with the average embezzlement scheme lasting 18 months before detection.

Embezzlement by definition is the ‘fraudulent appropriation of property by a person to whom it has been entrusted’. Prevention is often a significant challenge to the veterinary practice owner. It requires recognizing the environmental factors that enable embezzlers, improving your employee oversight procedures, and implementing a number of internal financial controls.

Who Embezzles?
The most costly embezzlement schemes usually involve one of your most trusted employees - but they could involve anyone – and the statistics are surprising. According to Gary Zeune, CPA, a nationally recognized speaker and trainer on fraud and embezzlement, only 5-10% of your employees would never, ever do anything wrong. Another 5-10% of your employees are always scheming. They generally show their true colors rather quickly and hopefully are short lived employees. It’s the remaining 80-90% that, if the conditions are right, they might consider embezzling.

In the 1950s, sociologist Donald R. Cressey developed a theory as to why people commit fraud. It is still one of the most widely accepted explanations of why seemingly average trustworthy people are enticed to embezzle. It’s termed the “fraud triangle” and identifies three key contributing factors: motive, opportunity, and rationalization. All three factors must usually be present for the embezzlement to occur.

Factor 1: Motive
Motive is a person’s need or the perceived pressure that the person is facing. The need could be a direct need such as stealing to solve a desperate financial problem or an indirect need such as a manager’s desire to make the books look good to ensure employment. The primary motives for an embezzler are the need for money, the desire to exact revenge, or the need for excitement or sheer challenge.

Financial
An employee’s need for money is often the result of some type of financial crisis at home. It could be related to deteriorating health issues with themselves or close family members, an addiction such as drugs or gambling, or the financial pressure of a failing marriage. Warning signs of an employee with a financial need include:

- Frequent requests for cash advances
- Employee receives telephone calls at work from creditors
- Wages are being garnished
- References are made to their participation in illicit activities such as gambling or excessive drinking
- Preoccupation with home related problems
- Friendships and associations with questionable people
- Irritability, easily frustrated, mood swings
- Poor self image over lack of wealth
It’s important to build a rapport with your employees and know them well enough to be able to detect signs of personal and financial problems, especially when their responsibilities include supervision of assets.

**Revenge**

Sometimes embezzlement will occur because employees feel they are unfairly compensated for their efforts. They justify the theft as a means of equalizing the field. These employees are often jealous of a doctor’s earning capacity and will frequently make comments about the differences in lifestyles between themselves and the owner. For this reason, it is important for an owner to resist discussing personal finances or buying habits in front of the staff. It is equally important that employees do not see any lax personal habits of owners such as dipping into petty cash to buy lunch or using company funds for personal purchases.

**Excitement**

These individuals often are thrill-seekers. They may be bored in their position or are simply looking for a challenge when the right situation presents itself. These individuals often exhibit attention seeking behavior and a strong desire to be number one.

**Factor 2: Opportunity**

The environment in veterinary practices is often very inviting to a potential embezzler. It is common in most practices that the manager has very broad administrative responsibilities. This enables any embezzlement to go undetected for extended periods of time. Furthermore, it is not unusual for a practice owner to exhibit indifference to financial administrative oversight. They feel they are too busy practicing medicine or they don’t like to focus on numbers which is why they’ve hired someone else to handle the finances. Many hospital managers attained their positions by graduating through the ranks earning a certain level of trust. Therefore, internal controls that might have been implemented with a new hire are usually forgone.

Practice owners often make little use of internal controls that are available in most practice management software such as using access codes, limiting the functionality for individuals or departments, or using passwords and audit functions. Some practices seem always to be operating in crisis mode. These practices are experiencing significant employee turnover and are training on the fly. By default, longer term employees are given more responsibilities and oversight than their position requires. All of this creates ample opportunity for unobserved activity.

**Factor 3: Rationalization**

This is the person’s justification for participating in the theft and often speaks to a person’s integrity. Individuals who embezzle because they are faced with a financial crisis often will rationalize that they are only borrowing the funds and will eventually pay them back when they are better situated financially. Some embezzlers excuse their behavior because they believe no one is being hurt or that the money won’t be missed. As discussed above, employees will often defend their actions as revenge because they feel they are overworked and underpaid and the company owes them. Researchers say that some individuals justify their actions because the money is going for a good purpose or that everyone else is doing it and they’re just taking their fair share.

**Methods of Embezzlement**

Most people think of cash when implementing controls to prevent embezzlement. While this is the most frequently involved asset, embezzlement can also include theft of inventory, services, and time. Below are some of the most common methods of embezzlement within the health care industries (human and pet).
Cash

- Writing checks to fictitious companies or to the employees themselves. Individuals will open bank accounts under their name but ‘doing business as’ (DBA) the fictitious vendor to deposit the payments into. Often the employee will create a phony invoice from the company to support the ruse.
- Opening a bank account under a very similar DBA company as the practice, i.e. Animal Medical Hospital instead of the practice’s name, the Animal Medical Center. In this manner, payments written to the practice can be deposited into the employee’s account with the bank taking very little notice of the difference in name. Many bank tellers will assume that the client just made an error. Or, the employee will use their ATM to make the deposit where there is no bank teller to review.
- Another variation on the above method is to create a bank account to a very similar DBA company as one of your primary vendors. Dual copies of the invoice are presented at separate time intervals with one of the payments being deposited into the employee’s DBA bank account.
- Falsifying invoices. Invoices are created for merchandise but the prices are inflated with the difference going to the employee.
- Writing checks to pay personal bills and recording in the practice books as legitimate practice expense.
- Presenting dual copies of invoices/statements for payment.
- Overcharging clients and pocketing the cash. This is especially common when clients use credit cards.
- Inputting a fraudulent return or client refund and pocketing the cash.
- Pocketing client payments to Accounts Receivable (A/R) and writing the debt off as uncollectible.
- Altering A/R statements mailed to clients or double billing clients.
- Cash is received and employee pockets the cash without recording that a transaction took place. This is the simplest method and frequently the hardest to detect.
- Pocketing vendor rebates.
- Using the company credit card to purchase personal items or running credits to personal credit cards.

Product/Services

- Inventory is ordered but never makes it to the shelf.
- Undercharging friends and relatives.
- Charging a client for a quantity of drugs, placing a lesser quantity into the vial, and pocketing the excess. This is especially problematic with controlled substances.
- Use of company resources for personal use - long distance personal calls made from the practice, use of in-hospital products on personal pets, use of company postage and office supplies, etc.

Time

- Falsifying time/overtime. This is sometimes easier to accomplish when not automated but not impossible even when a time clock is in use.
- Fictitious individuals are added to payroll. This is most common in larger practices with many departments such as boarding, grooming, and retail or with an absentee owner. Typically an embezzler will add the name and information of a family member.

Embezzlement Prevention

Of the three factors, Motive, Opportunity and Rationalization, the one that you can influence is Opportunity. Making a few slight adjustments can make a big difference in embezzlement prevention.

Owner Oversight

Practice owners should be diligent in reviewing their monthly bank and credit card statements. Ideally, these statements should be sent to the owner’s home address but at the very least, the statements should be received and reviewed by someone other than the person writing the checks or making the purchases. Each transaction on credit
card statements should be reviewed and compared against that month’s receipts. For purchases by telephone, a written pre-approval form should be required and available. Bank statements and copies of canceled checks should be reviewed for check alterations, check signatures, unique invoice/statement numbers on each check, and to ensure all vendors are approved.

Employees should believe that the practice owner participates in theft deterrent procedures. This could be evidenced by the requirement of the two signatures on all payments with the owner’s signature being the final signature after the check has been written out. An owner may want to personally mail all payments immediately after signing the check to eliminate any possibility of a check being altered or deposited elsewhere. Signature stamps should not be used nor should owners sign a number of blank checks for future use. An audit trail function can be found in most practice management software systems and when used properly, it can track every transaction that takes place as well as who performed it. After reviewing bank and credit card statements or audit report, the owner should make a habit of questioning a couple of the transactions.

When it’s necessary to hire for a position whose duties involve safeguarding assets such as practice managers and bookkeepers, a practice owner may want to consider using background and credit checks. It’s important to note however, that the typical person convicted of embezzlement is usually a first time offender. Research shows only 7% of fraud schemes involve individuals with prior convictions. A number of states require permission waivers from potential candidates so it’s important to know the state requirements before including background checks in your hiring protocols.

Division of duties
Duties relating to the same asset should be divided any time possible. The following are some examples:

- the person ordering is not the same as the person making the payment
- the person accepting cash is not the same as the person depositing cash
- the person preparing A/Rs is not the same as the person accepting payment for A/Rs; or, alternatively have payments of A/Rs mailed to a separate PO Box that only the owner has access to
- the person writing checks is not the same person reconciling checkbook

The decision to grant access to administrators or bookkeepers for on-line banking should be considered carefully. Generally there is a single password for access and once in, any user is allowed to perform a broad number of functions.

Internal Financial Controls
There are a number of operating procedures that can be instituted that will help reduce the opportunity and therefore the temptation for an employee to embezzle:

- As noted above, require dual signatures on checks or checks that exceed a certain value; never allow checks to be written to ‘cash’
- Require mandatory weeklong vacations for any personnel in charge of assets. Depending on the size of the practice, this could include the practice manager, bookkeeper, inventory manager, head technician and/or the head receptionist. Their time away can allow any irregularities to surface and be noticed by others.
- Use of pre-approval forms for: on line or phone credit card purchases, ordering from a vendor not on the approved list, request to add vendor to approved vendor list, purchase orders that exceed a certain amount, bad debt write offs, etc. These forms should be kept on file for use when reconciling bank and credit card statements.
- Reconcile purchase orders to the invoices, invoices to the statements, and statements to the checks; Invoices/statements should be hand canceled to avoid dual copies of invoices being presented, i.e. “paid by check #, date”
- Require a daily reconciliation of cash and credit card deposits to the practice management software’s record of receipts
• Practices may want to forgo any discounts received for paying from an invoice. Instead pay from statements to reduce the risk of being presented with a copied invoice for payment.
• Assign individual computer access and password codes to each person and do not provide more authority than the position requires. For example, there should be very little need for an assistant or receptionist to have the ability to perform functions such as price changes, returns, or removal of debt from a client’s file.
• Require a witness for client returns, employee purchases, and transaction voids or corrections. The type of employee that can be used as a witness could be limited to doctor on duty, manager, or owner.
• Keep petty cash accounts very small or have two people sign off for cash disbursements.
• Require that all clients must receive a receipt; all refunds must have a copy of the receipt printed with the client’s signature confirming cash was received and placed in that day’s cash drawer.
• Require that all returns on purchases made by a credit card be credited to that card only.
• Require that all checks be endorsed immediately upon receipt as “for deposit only, practice name.”
• Employee reimbursements must always be accompanied by two receipts, the receipt for the item being reimbursed, and a receipt that contains the employee’s signature acknowledging the reimbursement.

Internal Inventory Controls
• Forbid employees to make personal purchases directly from vendors through the practice.
• Use of locked central inventory storage system. Limited amounts of inventory are on the shelf with the bulk of inventory locked up.
• Use of an approved vendor list; keep list minimal and require a pre-approval form if ordering from a vendor not on the list.
• All employee purchases going out the door must have a receipt attached. Furthermore, employees should not be allowed to enter transactions into their own file.
• Consider use of video cameras where assets exchange hands and at back door. This is both a safety issue as well as theft prevention. The employees should believe that the tapes are regularly reviewed.
• At random intervals, conduct partial inventory counts particularly with high ticket items such as flea and heartworm products, NSAIDs, and controlled substances

Warning signs
Methods of embezzlement are limited only by one’s imagination. You can have a number of internal controls in place that can still fail especially when two or more employees are colluding to prevent detection. It’s important therefore to recognize warning signs that the practice may be threatened.
• An increase in client returns, refunds or bad debt write-offs. This could be concealing pocketed payments on accounts receivables.
• Decreasing bank check balances with no perceived decrease in business
• Declines in cash sales. Keep in mind that pocketed cash sales are the easiest scheme for an employee to pull and most difficult for an owner to detect. You may only notice this if you are aware of your practice’s typical deposit mix of credit, cash, and checks and you recognize a change in the mix.
• Frequent inventory shortages. This could be indicative of fictitious purchases, unrecorded sales, or employee pilferage.
• Declining profitability
• Delays in accounts receivables being paid off

Often there are noticeable changes in employee behaviors. Sometimes employee traits that owners perceive as devout and loyal really are just contributing factors to the deception. Owners should watch for:
• Employees that are very controlling of their workspace or refuse to teach other employees his/her job
• Employees that hold work over to the next day rather than letting the next shift complete the tasks
• Employees that prefer to work unsupervised
• An employee that is always first to arrive, often stays after hours, or frequently takes work home
• An employee that does not appear to want to take vacations
• Highly critical employees that are quick to assign blame to other team members
• An employee that frequently asks the owner to sign checks when they are busy or distracted
• An employee that has a financial lifestyle that exceeds their position
• An employee that is resistant to any changes in operation or accounting systems.
• An employee that has no explanation for frequent mistakes

**Conclusion**

We have several clients that have had significant embezzlement in their practice. You do not want it to happen to you.

It’s ideal to have these controls written down in a security plan as part of your employee handbook that includes the repercussions. Knowing the owner is vigilant is a theft deterrent in itself. You may also want to consider having an outside audit performed annually by your CPA as part of your year end review. These preventive measures are not to disparage your good hardworking employees. Rather it is crucial to establish a workplace where employees feel appreciated as a method of reducing an employee’s willingness to participate in such schemes. Good employees will recognize the necessities of the controls and why they are in place.

Practice owners must be pro-active in protecting their business’ assets. As the saying goes, an ounce of prevention…

---

Sherry Everhart and David McCormick are veterinary practice appraisers and practice management consultants with Simmons Mid-Atlantic. They can be reached at SEverhart@TMcCG.com and DMcCormick@TMcCG.com