



GH&J Food Digest

A Food Industry Newsletter



Green Hasson & Janks LLP
Business Advisors and CPAs

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In the previous newsletter, we interviewed four prominent food service executives and got their take on reducing operational costs in today's tough economic environment. In this edition, we will address a potentially greater financial threat to the food industry; fraud. Fraud may be the biggest problem facing companies and they may not be aware they are fraud victims.

According to the 2008 "Report to the Nation on Occupational Fraud & Abuse," a survey based on 959 cases, the average company loses approximately 7% of its total annual revenue to fraud and abuse committed by its own employees.

Consider these scenarios:

1. A loyal and trusted bookkeeper of a local Tortilla Distributor issues fictitious credit memos for customers who have already paid their outstanding invoices and deposits well over \$200,000 in her personal bank account.
2. A salesman on a business trip takes a \$10 taxi ride from the airport and is given a blank receipt to complete in which he claims \$17 on his expense report.
3. Relatives of a successful business owner are running a company division. For years, the division has purchased mixing machines at \$50,000 each. Recently, the relatives negotiated with a new vendor to purchase the same mixer for \$40,000. Excellent negotiating, however, the vendor is invoicing the company \$45,000 and the relatives and salesperson are splitting the \$5,000 kickback.

Each of these is an example of fraud, but only one of the scenarios will likely result in a response from management. For example, in Scenario 1, management may not pursue a conviction because it could lead to public embarrassment for not having preventative fraud measures. In Scenario 3, in order to prevent a family feud, the family may allow their relatives to continue their practices.

Steps To Prevent Fraud

The best defense against fraud is acknowledging that it can happen to you, establish preventative measures, and communicate to employees that the company is actively taking steps to prevent fraud. In our estimation, the majority of fraud could be prevented through awareness and implementation of effective preventative measures such as having clear management controls, employee considerations and a strong work environment. By focusing on these areas, a company can minimize the risk of being a victim.

Management Controls

The first step to proactively prevent fraud is for management to create an overall written company policy on fraud and crime. The following are items to consider when drafting and implementing a policy.

Content

- The policy should state that management is responsible for knowing exposures to wrongdoing and for establishing controls and procedures for detecting suspected illegal activity.
- Include a clear statement forbidding illegal activity, including fraud for the benefit of the organization, and that suspected wrongdoing will be fully investigated.
- A statement should be made requiring any employee who suspects wrongdoing to immediately notify their superior or those responsible for investigations.
- The company's policy should state that suspects will be treated consistently without regard to performance, position held, or length of service.
- Consider a policy regarding computer security and ensure every employee understands the policy concerning Information Technology.



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- Include a statement that the company should check bank and credit references of new suppliers and customers through outside credit agencies. Ask new or risky customers for partial payment in advance, or initially limit the amount to these customers. Consider requesting personal guarantees.

Implementation

- This policy should be disseminated to all employees, including managers and supervisors.
- Ensure all employees understand the fraud policy and procedures. It is important for each employee to sign the fraud policy to acknowledge their understanding and compliance.
- Your company's fraud policy should be reviewed annually with each employee.
- Any changes in the fraud policy must be communicated to all staff as soon as possible.

Consider taking your fraud prevention policy a step further, and include an ethics component. An ethics training and policy will reiterate the importance of fraud prevention and employee responsibility. "Ethics training will build an atmosphere where any malfeasance would not be tolerated by the 'Team' (peers)," says William Bradley, CFO of TK Services, Inc. "[Ethics training] fosters an attitude of trust and sets in place a zero tolerance action if that trust is broken."

Employee Considerations

Implementing a policy is important to ensure that employees understand their role in preventing fraud, but also to state the company's position on fraud. As an employer it is key to do your due diligence and set employee regulations. The employee considerations below can be applied to new and senior employees.

- Carefully check all references; both personal and credit.
- Clearly define job descriptions and make sure all employees know who to report to if a problem arises.
- Avoid having "indispensable" employees who understand all the inner workings of a particular part of the business. "Separation of duties is a key internal control procedure whenever possible", says Simon Tam, Controller of Le Chef Bakery. "The person who performs the cash deposit function should not authorize credit memos or perform cash applications to customer accounts."
- Most fraud requires regular activity by the fraudster - encourage employees to take regular breaks and vacations.

Work Environment

Lastly, having a responsive and pleasant work place should not be underestimated. "The most important element of fraud prevention is probably the culture or work environment that executives and management establish for the company," says Tam. Leading by example and providing opportunities for acknowledgement are only some of the ways to prevent fraud.

- As noted above, have a clear policy whereby all irregularities will be dealt with, no matter how small. Set an example from the top - employees will follow the example of management.
- Dissatisfied employees are more likely to be tempted by fraud. Treat everyone as part of a team and recognize the contribution each person makes. Remember, fraud in the company leads to low workplace morale. Respect for management becomes damaged and staff turnover, particularly of good employees, is likely to increase.
- Set up a fraud hotline whereby employees may call a 24-hour anonymous service to report any suspected fraud and abuse.

It is important to note that the measures outlined in this newsletter are preventative and by no means ensure that fraud will not be perpetrated. These are steps to begin building a culture of trust and awareness in the workplace. Bradley adds, "Ultimately it is the veracity of the employee that determines whether they will or not perpetrate a fraud."

About Don Snyder

Don Snyder, CPA, is an Audit Partner with Green Hasson & Janks LLP, and a well known business consultant in the food distribution, food processing and manufacturing industries. He has written numerous articles geared towards improving internal controls and fraud prevention measures. Don has over twenty-five years experience in public accounting.

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