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Absence of Checks and Balances: A Fatal Mistake of International Business

Introduction

Companies often increase their susceptibility to fraud when setting up operations overseas. They underestimate the importance of understanding the new operations, adapting to different norms, and taking the time to build trust and monitoring systems into overseas teams. All these oversights create an environment that lacks the checks and balances needed to discourage theft while keeping your assets and your business safe.

Areas of High Vulnerability

Inventory and Supplies

Inventory shrinkage and loss of supplies are huge problems for all businesses, and even more so when employees do not have personal connections with the company's leadership. This is often the case in international ventures. A 2013 survey by Kessler International found that 52% of employees surveyed admitted stealing office supplies and that 94% of retail businesses were victims of retail crime, of which 44% was due to employee theft of inventory (LFN, 2013). Some of these actions may seem harmless to an employee that feels like they need the goods more than the company does, especially when they feel like there is little chance of getting caught.

Cash and Checks

Cash and checks are high risk areas for any business because the money can easily be stolen without strong internal controls in place. Often foreign subsidiaries need a fair amount of cash on hand to pay for smaller or miscellaneous expenses that cannot be paid electronically. Yet the ease of falsification of cash receipts creates vulnerabilities. Businesses have a moral imperative to make employee theft as difficult as possible. Having relaxed cash controls may be an almost overwhelming temptation to an employee facing tough financial times. Separation of duties is always the first step in theft prevention, e.g., the person in charge of accounts payable should never be the same person who signs the checks.

Bookkeeping

One person in charge of keeping track of the finances and reconciling all accounts can easily commit fraud. If there is a lack of checks and balances, that person is much more likely to attempt the theft. Additionally, dealing in foreign languages, currencies, customs, and practices further complicates transaction supervision, making it easier for fraud to go undetected. To protect your business, separate responsibilities so that one employee cannot alter anything without someone else noticing. In accounting terms this is called segregating financial responsibilities. For example, a company may have one person keep the books, another person collecting receivables and yet another person handling accounts payable. No one has all the financial power or responsibility, and finance professionals from both countries are in the loop.

Why do people commit corporate theft?

If you can NEVER think of an instance where it might be okay to commit corporate fraud, then you are fortunate. Perhaps you have never been in dire financial stress and/or you have a solid moral compass that mitigates the temptation of theft or collusion. Yet, unfortunately, it is not uncommon for people to succumb to stress and temptation. In developing nations where hardship is widespread, sociologists have concluded that poverty is the primary source of crime (Begus, 1976). Ethical standards differ from one country to the next, and employees' attitudes toward authority, rule following, risk, and loyalty vary greatly from one culture to the next. That is why it is imperative that you work to understand where your employees are coming from, what motivates them, how to create loyalty and trust, and how to create systems of checks and balances that erodes the temptation for corporate fraud.

So why do people commit fraud? Below are 3 of the top reasons according to the Association of Certified Fraud Examiners (Report to the Nations, 2018). Understanding them is the first step to prevention. When you are able to hire, lead, and manage from a place of empathy and awareness, your international ventures will have a much higher chance of success.

Financial Difficulties – Need is one reason individuals steal from their employers, and while a need might be based on some particular hardship or change in income, in collectivist cultures, family hardships may also be a driving force for theft. Sometimes, employees having financial difficulties will think stealing from their place of work will solve their problems.

Disgruntled Employees - Many times corporate fraud is caused by disgruntled employees who feel they are being overworked, underpaid, or feel their employers are taken advantage of them. It is proven that companies with high morale have fewer instances of employee theft, and in some cultures, interpersonal relationships and feelings of mutual respect are greater deterrents of fraud than others.

It's Too Easy – In a recent survey, 24% of people who think it's okay to steal from work state the reason is because the company won't notice anything missing (Gillis & Simpson, 2020). For instance, employees who know their employer doesn't monitor inventory won't likely feel at risk for being caught stealing, and many in-house bookkeepers with little or no supervision have opportunities to cook the books. Employees who have no criminal background and who are not necessarily prone to stealing are more enticed to steal if the opportunity is present and the consequences set in place by the employer for theft are minimal or are not enforced.

How to create a system of checks and balances in your international operations

So now that we have a better idea of some of the common underlying reasons behind corporate fraud, how do we prevent this in your international business ventures? How do you create a checks and balances system that not only prevents fraudulent activities and allows quick and easy detection, but more importantly, creates an environment that reduces the temptation to steal?

- **Identify the vulnerabilities specific to your business.** Do not label your employees as vulnerabilities depending on your relationship with them. Don't assume sending a trusted employee from your home office to a foreign subsidiary will make everything okay. Even the most trusted, long-term employees are capable of theft in put if the wrong situation. Instead identify vulnerabilities by responsibilities and the positions in charge of them.

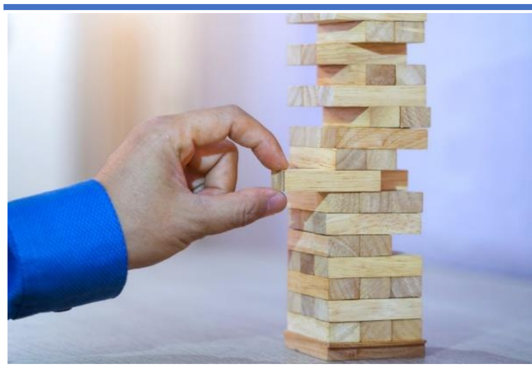
- **Segregate duties so that no one person or department has control over the vulnerable areas of your business.** Have a rotating schedule for your inventory audits, and make sure the person who orders the inventory is not the same person counting it. Make sure cash related activities within your accounting department are split up between two or more employees. Make sure employees from your home office are involved with overseeing foreign operations.

- **Monitor vulnerable activities.** It may not always be possible to have a physical presence at your international offices so, whenever possible, invest in technology and outside resources to be your eyes and ears for you. Technology can take the form of automated inventory tracking systems, cameras, email surveillance, real-time cloud-based accounting systems and alerts. Outside resources can mean third-party accounting firms that conduct no-notice audits. Make sure all bank and credit card statements are reconciled monthly along with all GL accounts.

- **Bring off-shore executive team to your home office for as long as possible.** Establish real, interpersonal relationships with your international team. Take the time to connect, establish trust, and earn respect and loyalty. Do not assume it is there from the beginning.

- **Let Employees Know.** Checks and balances in your international operations should never be a secret. Your goal should not be to surprise and trap employees but to encourage them to stay honest. If they know that their actions are being monitored, they have an incentive not to cheat. Follow up with every lead or alert that may arise in a consistent, non-accusatory fashion. This will let your team know that you are serious about protecting your assets without pointing fingers.

Conclusion



There is no easy recipe to essentially "trust but verify", but the tips above should get you on the right path. It is also important to note that your checks and balances efforts must be ongoing. Not only do you need to establish these practices, but you also will need to remain vigilant in your monitoring and enforcement.

Sources

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