The Tale of the Trusted Employee
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A trusted employee takes a payroll advance; the harried executive director (ED) signs the advance cheque without question. Over a period of a few months, the advances increase in frequency, and the repayment of these advances slows. Soon, an extra paycheque for the employee appears in the pile of cheques to be signed by the now-frantically-busy ED, and again the cheque is signed without question. Over the ensuing six-month period, more advances and more extra pays are issued, until the auditor inspects the records and finds surprisingly large amounts overpaid to this trusted employee.

What has happened here? Fraud by a conniving schemer? Simple error or oversight by an incompetent or too-busy employee? Or, something else?

On the one hand, most reasonable observers will find a pattern of duplicate pays to be too coincidental to be an error: fraud seems to be the answer. On the other hand, the first in this series of events – a simple payroll advance – would hardly raise the suspicions of the most jaded among us. So, what went wrong?

"It is a fraud to borrow what we are unable to repay"

~ Publilius Syrus (Roman author, 1st century B.C.)

This very real example from a client of mine several years ago highlights an all-too-common situation, one that starts innocently and ends very badly.

We often think of honesty as a black-and-white situation: a person is either honest or dishonest. The only thing separating successful fraud from unsuccessful is the intellect of the fraudster and the gullibility of the defrauded. But the reality is far more nuanced. The reality is far more human.

Studies of ethical behaviour suggest something far more complex at play. While, indeed, a portion of the population seems to be invariably trustworthy regardless of the circumstances, and a similar proportion is invariably untrustworthy, there is a large middle ground that defies such easy classification. It seems that a majority of people, while generally honest and ethical, can stray into unethical behaviour in certain circumstances. And, only rarely are these circumstances entirely of the individual's own making.

At play here is the powerful and exclusively human trait of rationalization. Rationalization is defined in dictionary.com as the ability "*to ascribe (one's acts, opinions, etc.) to causes that superficially seem reasonable and valid but that actually are unrelated to the true, possibly unconscious and often less creditable or agreeable causes*." That is, rationalization allows us to separate our actions and beliefs from their real cause and connect them with reasonable-sounding, though untrue causes.

“The eyes are not responsible when the mind does the seeing.”

~ Publilius Syrus (Roman author, 1st century B.C.)

This is illustrated by the thoughts that might have run through the above employee’s head as they realized, first, that employee advances were not being effectively monitored, and, later, that additional pays were not being noticed:

- *“I've been working so hard that I can’t be expected to remember every advance that I’ve taken. If they don’t want to follow up to be repaid, that’s their problem.”*
- *“The organization doesn’t need the money as much as I do. If they did, they’d be all over me.”*
- *“I work so much overtime here that I deserve this extra pay. That’s probably why nobody has even questioned it.”*

If this employee found a wallet lying in the street with a large sum of money in it, odds are they would turn it into the nearest police station. But, when circumstances give rise to powerful rationalization, something changes. All of a sudden (or, more likely, over a period of months), an honest, trusted employee has become a fraudster. A previously valuable contributor to the organization’s work has sacrificed their career and exposed the organization and coworkers to upset and loss.

So, what are the circumstances that can trigger this Jekyll-and-Hyde behaviour? Could the organization itself have had a role in turning a valued employee into a fraudster?

Let’s be clear about accountability and responsibility in this situation: nobody but the employee herself can be responsible for her own actions, and nothing in this discussion excuses this conduct in any way whatsoever. But, when we are discussing this situation with our risk management hats on, it bears considering whether a climate that fosters unethical behaviour has been inadvertently created by the organization, or whether procedures are such that fraud is as simple as a walk in the park. Are there reasonable, cost-effective steps that can be taken to guard against what appears to be a very common human trait, to rationalize an occasional error or innocent act into a pattern of deception and theft?

A climate of dishonesty

First and foremost, an organization’s culture is set at the top. If leadership does not live up to the highest ethical standards, that is soon noticed – and followed – by the rest of the organization. At a minimum, this behaviour constitutes permission to behave similarly, and more likely, it is seen as direction-setting. So, if the ED pads her expense report with personal expenses (and don’t think word won’t get around about it!), why would others refrain from doing so? If the board directs work at above-market rates to a relative of the board chair, why wouldn’t staff apply similar criteria to their work? When you think about, how could any but the most saintly employee be expected to behave better than her bosses?

“An employee's motivation is a direct result of the sum of interactions with his or her manager.”

~ Bob Nelson

Adverse working conditions also provide fertile ground for rationalization. Extreme overwork can burn out the most diligent employee, throwing her life seriously out of balance, and driving compensating behaviours ("*why not take the spouse out to a good dinner and expense it as donor relations – I've donated lots of my evenings to the organization*!"). Unfair hiring or promotion practices can cause discontent and anger among staff ("*I deserved that promotion and raise, so I'll just take the pay increase another way!*"). Short term savings on the backs of employees may have unintended costs not so far down the road!

Of course, the first line of defence here is with management. The ED, for example, should step back and try to objectively assess the organization's culture and work environment. Before any particular suspicious behaviour becomes apparent, these cultural and environmental clues can be an important early warning. This is also where the board may have a valuable role, particularly where the ED has been in her position for many years (and is therefore so much a part of the environment, that it is near-impossible to be objective.) And, the board should be particularly attuned to management behaviour that is anything less than exemplary.

Weak procedures

That said, not all circumstances that contribute to wavering ethics arise in the workplace. An employee may be facing difficult personal circumstances – financial problems, or a family illness, or any one of a multitude of stresses – that she brings into the workplace every morning. How to guard against this?

"Fraud and falsehood only dread examination. Truth invites it."

~ Samuel Johnson (English Poet, Critic and Writer. 1709-1784)

Procedures within the organization need to provide a degree of assurance that unethical or inappropriate behaviours – whatever the cause – do not put the organization or its resources at risk. Far from showing a lack of trust of employees, effective control procedures make trust unnecessary. They let managers be appropriately concerned for their employees' effectiveness and well-being without having to be suspicious of the impact of every behaviour. (This is not to say that managers should be blind to the impact of employee behaviours, but simply to say that their appropriate priority should first be preventative – in looking at the wellbeing of the employee.)

So, what procedures would have avoided the difficulty that our troubled employee got herself into? Presumably, the first problem was that the employee in question had the ability to write cheques and submit them to the ED for signature. Of course, someone has to have this responsibility, but the first control is to limit this ability to those who are responsible, for example, by having cheque stock under lock and key, and by password protecting the computerized accounting system that generates cheques. Second, employee advances should be the subject of a specific HR policy, that limits the frequency and amount of advances, requires appropriate managerial approval, and dictates strict repayment (likely through automatic withholding of all advances from the employee's next pay). Finally, the accounting for employee advances should be separate from the issuing of advance cheques, and the advance account closely monitored for timely repayment.

The issuance of extra pays highlights numerous weaknesses in the organization's payroll procedures. Among the controls that might be put into place: the use of an outside payroll service, with appropriate limits and approval processes on pay rate changes and additions of employees; the monitoring of detailed budgets by department or program that would highlight any extra amounts incurred but not budgeted; the reconciliation of payroll system amounts to the accounting system entries, and comparison to approved head counts and pay scales; and so on.

The use of some or all of these procedures, coupled with attention to the organization's culture and working environment, would in all likelihood have prevented what probably started as an innocent advance from turning into every organization's worst nightmare. When viewed in this light, the 'cost' of improved controls and a stronger culture and work environment is much more reasonable than the alternative.

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The article above serves as an introduction to internal control, the process of designing and implementing procedures and steps to ensure that organizational objectives are achieved. Internal control is a vitally important part of financial risk management, and will be explored further in future articles.