Minimizing the Risk of Fraud

BY THANE JOYAL AND MARK GOEHRING

Loss prevention is a key piece of the retail grocery business. Co-op managers are aware of this at their level and manage against it every day, but everyone in the cooperative needs to pay attention to the possibility. Board members: don't be complacent.

There are myriad ways to steal from a grocery store: at the register, at the loading dock, at the safe, and at the computer. It's important that directors of retail food co-ops educate themselves about the basics of loss prevention and implement basic best practices to ensure that their co-ops are not vulnerable to fraud. Chance favors the prepared mind: fraud can be extremely difficult to discover, and many frauds are discovered only by chance. There's no way to actually make a business "fraud-proof"—but there are plenty of ways to limit the likelihood of it happening and to limit the impact if it does.

Be prepared!

Have a financial review or an audit every year. Have an audit every three years at minimum.

Regularly request and review information about the financial condition of your co-op. Ask questions until you understand the financial information presented to the board.

Educate yourself by asking the general manager for board training on grocery retail basics:
- cash handling practices at your co-op.
- inventory practices at your co-op.

Verify financial information occasionally and when a trend develops. If the explanation for a trend references a sector-wide cause, ask for source data.

Look for the following practices within the store:
- bonding for key employees
- criminal background check for key employees
- a realistic and practical whistleblower policy
- an accounting manual that outlines the duties of people handling assets and how those assets are safeguarded

Be a good employer and a professional board—be worthy of respect. Use best practices in hiring your GM. Be timely and fair compensating your GM.

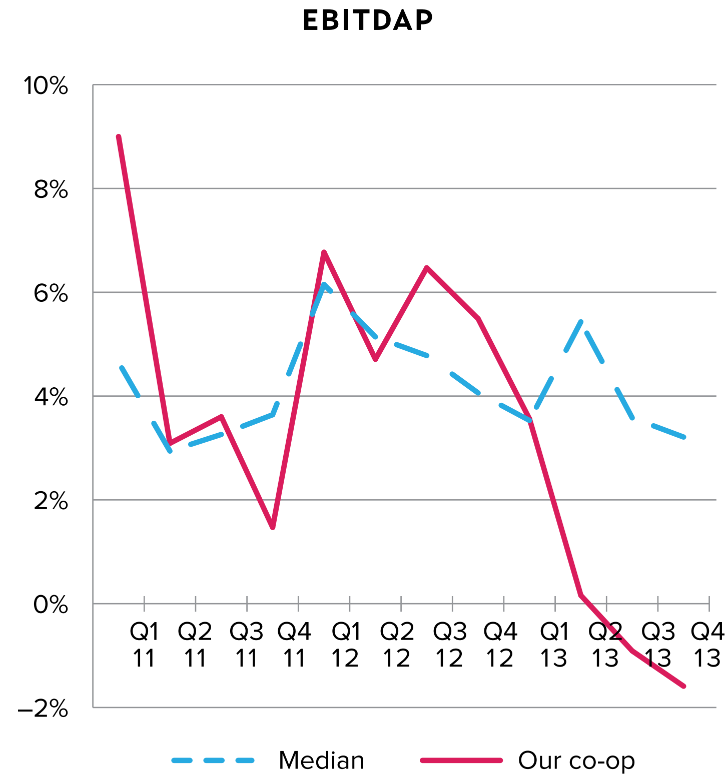
Listen to everyone: don't overreact, but don't ignore rumors either.

What if we suspect fraud?

Get expert assistance early. Consult your co-op's attorney first. Forensic accountants specialize in detecting fraud.

What if it happens to us? Have a communication plan. Know what you can say and what you cannot say. Control information flow to protect confidential information. Practice answering owner questions.

Learn from the experience: institutionalize practices that will prevent a reoccurrence.



◀ apparent if the board sees only an income/expense statement.

EBITDAP

EBITDAP (Earnings Before Interest, Taxes, Depreciation/Amortization, and Patronage Refund) is a ratio that reflects core earnings of the business; it is sort of like an EKG, a way to analyze the body's beating heart. By filtering out the effects of financing and accounting decisions, EBITDAP offers a useful way to compare your co-op's profitability with that of its peers.

In this case, the board of "Our Co-op" might have a stated expectation that EBITDAP should be above the median for the co-op's peer group. This chart tells the board that their business is seriously underperforming both in relation to what's possible and to their expectations. In addition, the board knows that the downward trend in EBITDAP began in 2012, with serious decline in performance beginning in the 1st Quarter of 2013.

Probably the board has been asking their manager some important questions: What's happening? Which aspects of this trend are common to all of our peers, and which are specific to our co-op? If you tell us there is a common cause, what is it, and how do you know? How are you managing this situation? What's your plan?

The answers to these sorts of questions will then tell the board how particular business decisions have affected their co-op's health, and about whether they have the right manager. If the board members had only looked at the income/expense statement and had never stated an expectation about this indicator of financial health, they might have never asked the important questions or heard the answers.

Debt to Equity

The debt-to-equity ratio is an indicator of how much money a co-op owes (things such as accounts payable and bank loans) in comparison to how much it owns (paid-in equity, retained patronage dividend, and retained earnings). Co-op leaders can use this ratio to understand and make decisions about the co-op's ability to take on and pay back debt.

In the case of the example at the top of page 25, the board can see that their co-op has relatively very little debt, and this has been true