

# Protect Your Business From Fraud

While employers are focusing on a struggling economy, concerned with maintaining clients, keeping vendors honest and managing to keep their business in the black, employees are also struggling. Many of your employees may be dealing with the effects of an unemployed spouse, inability to pay creditors and fighting to stay out of foreclosure. More and more of these struggles can lead to employee theft or fraud in the workplace.

## Types of Fraud

There are numerous fraud schemes employees as well as vendors take part in that cost employers billion's each year. Some of the most common are listed below with a brief description of how each occurs.

*Ghost Employees* – fictitious employees added to your payroll

*Falsified Hours and Salary* – dishonest employees adding time or adjusting their own salary; supervisors may even approve the time for a share of the additional pay

*Commission Schemes* – sales employees overstating commission by falsifying amount of sales or commission rate

*False Workers Compensation Claims* – fraudulent work-related injuries, especially if the employee foresees company layoffs; employees may also work with a dishonest doctor to justify and/or prolong the claim

*Skimming* – employees with cash access pocket the money

*Fictitious Vendor Billing* – employees approve vendor bills for goods or services that were not received by the company; typically the vendor is a fake company set up by the employee or a company that is a friend of the employee

*Fabricated Refunds* – employees “refund” purchases and issue cash refunds to themselves

*Cash Larceny or Forgery* – employee with check writing authority writes checks to themselves while coding the expense to various expense accounts

*Expense Reimbursement* – employee submits reimbursement for non-work related expenses or may request an additional copy of a receipt and submit the expense twice

*Inventory* – employee purchases items and has them shipped to a personal address

*Corruption Kickbacks* – approving overstated vendor invoices and then sharing the increase with the vendor

*Fraudulent Financial Statements* – employee responsible for preparing financial statements purposely misstates account balances because they have either stolen something or have their personal bonus based on company performance

*Counterfeiting* – an outside vendor or employee duplicates a blank check using your company's bank account and routing number

*Paperhanging* – an individual uses checks from a closed account to make purchases, sometimes returning the goods for a full refund

## Preventing Fraud

Internal controls are the first step to preventing fraud and are probably a phrase that your accountant or auditor has used many times, but what does that really mean? Having proper internal controls means not allowing one person to have too much control or total control over a single process. For example, in the purchasing department, an ideal process would be to have an employee responsible for creating a purchase order, another employee to review and approve the purchase and a third employee receiving the shipment and comparing the items received to the packing slip and to the original purchase order. If one person handled all three functions, it would be very easy for an employee to falsify a purchase order, approve it for payment and then have the goods shipped directly to their home.

Unfortunately, a lot of small companies do not have the luxury of affording several employees to create a check and balance for each process. Additionally, with the possibility of cutting staff, employers are faced with eliminating the internal controls in place. There are still options available to owners to help mitigate employee fraud when internal controls are lacking.

### *Background Checks*

Requiring all employees to undergo a thorough background check, including credit check, will provide assurance that the employee does not become a repeat offender. Routine background checks for current employees may also uncover employees with financial difficulties or a new criminal record.

### *Review Payroll Register*

Owners should review payroll registers each pay period, or at least frequently throughout the year. The review should consist of the following:

- All employees listed should be active employees
- Employee wages should agree to approved salary forms
- Individual employee hours should sync with approved time sheets
- Consider hand delivering paychecks to each employee to verify each employee receiving a check exists

If the payroll register was not received directly by you, consider performing the following:

- Sum the total gross wage by employee and compare it to the total gross wage of the report to ensure no employees were deleted
- Compare the total gross wage on the payroll register to your invoice
- Review your bank statement to ensure the total invoice was the amount disbursed from your account

### *Pre-numbered Forms and Checks*

Implementing the use of pre-numbered forms and checks allows for a numerical review of all transactions. For example, if purchase orders were all pre-numbered and an owner wanted to review all purchases, they could simply request a copy of all purchase orders, easily noticing a missing purchase order number.

### *Job Descriptions*

Make sure each job title at your company has an updated job description. If staff cuts are required, a review of an employee's job duties can provide insight to a possible delinquency of internal controls. For example, if the person responsible for approving purchase orders has been let go and will not be replaced, then another person outside of the purchasing department should be required to approve the purchase.

#### *Review Bank Statements*

In several fraud cases, the employee perpetrating the fraud has falsified the bank statement; therefore, the owner should open the bank statement directly from the bank to mitigate this risk. Once open, the owner should review all canceled checks, noting proper signature and reviewing the numerical sequence to ensure they are all accounted.

#### *Review Vendor Lists*

Request a list of all vendors in the accounting system. If the vendor is unfamiliar, ask for the vendor invoice or call the vendor to verify legitimacy.

#### *Control Cash Receipts*

Ensure that the person that opens the mail and makes the check deposits does not have access to the accounting records. In many organizations the person that makes the check deposit is the receptionist while accounting records the receipt and reviews aged receivables to ensure clients remain current.

#### *Annual Audit or Agreed Upon Procedures*

During your annual audit, your auditors should perform a review of your company's internal control and notify you of any deficiencies. If you do not have an annual audit, you may want to contract with a Certified Public Accountant to perform a review of your internal controls, making recommendations for improvement.

#### Questions or Concerns

Employee theft is a scary reality that most employers believe will never happen to them. Beware that it can! By partnering with Tandem HR you have already taken steps to mitigate fraud by having our experts manage workers compensation claims and enlisting a third party to process payroll. Additionally, we can help you implement background checks on all employees and candidates and ensure your job descriptions are current. We are here to answer questions you may have about internal controls. If you suspect fraud, our Human Resource department will work with you to enlist the help of experts to investigate.

*For more information, contact Tandem HR at 630.928.0510 or visit [www.tandemhr.com](http://www.tandemhr.com). The staff at Tandem HR contributed to this article. It is intended as information only and is not a substitute for legal advice. Tandem HR is a professional employer organization specializing in strategic HR partnership with small and mid-sized businesses.*

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