



Protecting Your Business from Fraud

According to the Association of Certified Fraud Examiners report businesses lose 5% of their annual revenue to fraud.

Fraud in the workplace is a serious problem for businesses regardless of their size. In fact, the groups most susceptible to fraudulent activity are businesses with less than 100 employees. The good news is there are steps that can be taken to minimize your risks.

Know your Business

The first key to preventing fraudulent activity is to know the business. Business owners and top level employees should not only understand how the business works but be aware of how it compares with industry standards. A typical fraud scheme involves inflation of expenses on the income statement. Maintaining operating budgets and forecasts, and systematically reviewing and comparing those with actual numbers help to identify anomalies that would indicate processing errors, mismanagement, or possible fraud. Knowing how the business works and comparing it to others in the industry can also help top management spot inconsistencies that may point to fraudulent activity. Managers who have questions about how the business is operating or who need help with industry standards should seek assistance from a Certified Public Accountant.

Be actively involved in and maintain a hands-on relationship with the business. Know the vendors and employees. Numerous fraud schemes are perpetrated by creating fictitious vendors and/or employees. Also ask yourself the following question, "If I were going to steal from my business how would I go about it?" This will reveal areas that may be susceptible to fraudulent activity.

Know your Employees

It is human nature to want to trust others, especially if long-term relationships have been developed. Unfortunately today a number of factors exist that drive seemingly trustworthy employees to make bad decisions. The best defense against those bad decisions is to minimize the available opportunities and mitigate the risk upfront. Background checks provide one of the best defenses in hiring good employees. According to LexisNexis, more than 30% of all job applicants provide false information on their applications and resumes. Although background checks may not reveal everything they will provide you with a reasonably valid source of information regarding a person's past employment and possible criminal record.

It is also important to know your current employees work habits. Knowing work habits can help management notice changes in behavior that may indicate possible risk factors. A few of the common red flags regarding employee behavior are:

- refusing to take allowed vacations, or even more than one day off at a time
- working excessively on weekends or after business hours
- extravagant or major lifestyle changes inconsistent with income level
- sloppy records or bookkeeping, nervousness about questions regarding records

Although these behaviors can be common indicators of fraud or embezzlement, further investigation would be required. Certainly all employees will not commit fraud. Being aware of behaviors and staying informed and knowledgeable about employees will go a long way towards deterring fraudulent activity. If you catch an employee stealing from the business, you need to terminate his or her employment immediately. Giving employees a second chance is not advisable. There is truth in the old saying, 'Once a thief, always a thief.'

Control your Environment

Controlling the environment is the most proactive step a business owner or top management can take to prevent and deter fraud. Fraud studies indicate that 90 percent of the frauds committed could have been prevented if proper controls over business processes had been in place. Solid internal controls, implemented and followed correctly, are the best deterrent to fraud. Several internal controls are imperative - those controls are segregation of duties; examining support documentation; reconciling bank statements; and safeguarding your assets.

Certain accounting functions are designed to cross-reference each other for accuracy. If the same person is responsible for multiple duties, the checks and balances are removed, creating an opportunity for abuse that segregation of duties would eliminate. Giving a single person unquestioned authority of the finances is not a wise business practice.

Examining supporting documentation enhances communication and serves as a final checkpoint. Never sign blank checks or checks without original supporting documentation. Management should always question new business vendors or vendors that are not readily recognizable prior to signing checks or authorizing purchases.

Bank statements can only flag discrepancies if they are reconciled on a timely basis. Reconciliations should be done once a month and should not be performed by the person writing the checks. Also, the person writing the checks should not have authority to sign checks.

Safeguard assets. Access to important documents and supplies should be limited and monitored. Cash and checks should be deposited daily and blank check stock should be safely secured. The use of signature stamps is highly discouraged.

Internal control studies can be done by professionals to determine where weaknesses exist, and recommendations can be made to strengthen internal safeguards against fraud.

The final caveat is "Trust but verify." Trust is not the issue – the issue is verifying business transactions.

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