

BUSINESS FRAUD:

IT'S NOT GOING ANYWHERE

The Association of Certified Fraud Examiners (ACFE) recently released its annual study of global fraud. For 14 years ACFE has been surveying the world of fraud and not a lot has changed. Fraud remains an unnecessary part of and a significant cost to small business.

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ACFE estimates that a typical business loses about 5 percent of its annual revenue to fraud. However, based on our experience with small to medium size businesses in the Southeast, the number is closer to 2.5 percent, mainly because in our area we tend to have smaller businesses and fewer global organizations included in the survey.

What does that mean to most of our Southeast business owners? If you experience a fraud, you can reasonably expect to lose more money than you pay yourself. In the last two years, our firm has witnessed a number of frauds where employees took more than twice what the owners made and in several cases put the companies out of business.

Are there any red flags for which an owner needs to look? Perpetrators display two very common traits according to the ACFE. Living beyond one's means and personal financial difficulties both account for the most red flags. We have seen examples of both; in one case, the owner was tipped off by his wife's comments that his CFO had a newer and bigger house than they did along with several new cars!

How do employees get away with this? Owners often put too much trust in employees. There is no question that you have to trust your employees, but we highly recommend that owners maintain a healthy degree of skepticism at the same time. Let them know that you are looking at their work by questioning transactions and reviewing their work product even if you know it is correct.

How long does a small business fraud last? The typical small business fraud is going to last between one and two years. It is not unusual for it to start and then stop for a short period. This hiatus gives the dishonest employee time to see if their scheme is working without detection.

What do they steal? In a small business there are two very vulnerable areas. First are fraudulent cash disbursements. While there are a number of methods employed, there are three most common. The first involves billing schemes where employees set up outside shell companies to send fraudulent payments. Next are payroll schemes where an employee overpays themselves or even gets extra checks. And the third, often overlooked scheme is the expense reimbursement involving completely fraudulent supporting invoices or personal expenses being presented as business expenses.

The second vulnerable area involves non-cash schemes, which tend to be more difficult to detect. Among these is the ordering of supplies and related

~Charles W. Schulze, CPA, CFF, CFE, Shareholder



items that are diverted to personal use or for resale by the fraudster. Often overlooked is the most simple of frauds—the stealing of inventory or other assets of the company. If done in small doses, this scheme could last for years. These methods are very difficult to prove in court and are generally not simple to explain to a jury.

What can a small business owner do to minimize business fraud? Short of reviewing every transaction involved with your business, there are several polices you need to implement. First, remember to maintain a high level of healthy skepticism when dealing with employees. Stay involved in your business daily. Make it a habit to review bank reconciliations and payroll disbursements. Review invoices and disbursements regularly. Lastly, set an anti-fraud tone at the top. More than 40 percent of all frauds are uncovered by tips from employees. Make sure your employees understand that fraud will not be tolerated in your company and that fraud can put a company out of business and people out of jobs.

Unfortunately, there is no chance of eliminating 100 percent of fraud in businesses. However, implementing these policies, your chances of experiencing a fraud in your small business will be greatly reduced.

FRAUD AVOIDANCE TIPS FOR SMALL BUSINESS OWNERS

1. Devise a written corporate policy on fraud. Formally review the policy at a staff meeting.
2. Conduct background checks, check references and contact prior employers when hiring new employees. If you want to perform a criminal history and credit check, be sure to obtain the person's written consent.
3. Cross-train staff and segregate office duties. Require that employees take at least five consecutive days of vacation annually.
4. Be involved. Personally sign all checks. Review deposits daily. Review credit card statements. Send bank statements sent to your home address. Know how your accounting software works. Compare your financial statements to the prior period.
5. Conduct surprise audits. Make sure your employees know their actions are closely monitored.

~Theresa Kaake, CB, Accounting Resources Specialist

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