FACTSHEET

Identifying and preventing fraud

At Firmvalue Payrolls we can advise on a wide range of issues we know are important to businesses. This article considers strategies for identifying and preventing fraud.

Your business, like every other business, is threatened by fraud. Some estimates suggest that fraud could be costing the UK economy in excess of £30 billion a year. It is essential that you are aware of some of the most common types of employee fraud, that you can identify them when they do happen and, ideally, prevent them from happening at all.

There are, broadly speaking, two types of employee fraud. Fraudulent financial reporting is usually committed by senior officials or management, and involves altering financial statements to deceive business owners. Misappropriation of assets is far more widespread and can be committed at any level by any employee and in many different ways. Here are some common areas where fraud can take place.

Personal and company cheques

There are numerous fraudulent schemes that employees can carry out using personal or company cheques. Here are some examples, along with the action you can take to prevent them.

- An employee writes a personal or company cheque payable to cash and posts the debit to an expense account. He or she then discards the cancelled cheque when it arrives with the bank statement and reconciles the statements, attributing the debit to an expense account or inventory that is closed out at the year's end.
- An employee takes money from the petty cash and replaces it with a personal cheque. The cash box is therefore always balanced, but the cheque is not deposited into the company bank account.

Action:

- Examine bank reconciliations thoroughly
- Scrutinise bank statements and cancelled cheques for cheques made out to cash, to employees or unusual vendors
- Instruct the bank to post company statements to your home address for your personal review and reconciliation every month.

Credit control

The department responsible for collecting debts and bringing money can offer temptations for less honest employees. Typical scams include:

- "lapping" – here an employee receives a payment from a customer and transfers the money directly into his or her own pocket. When a second customer makes a payment, the employee credits the

first customer’s account. This “lapping” process is repeated until determining exactly what has happened and what is lost becomes very difficult.
- An employee posts credit notes or other non-cash reductions to a customer’s account and pockets the cash.
- An employee alters the company copy of a sales or work invoice to reflect an amount less than was actually billed. He or she then pockets the difference.

Action:

- Verify credit notes and write-offs with receiving records, checking for other documentation supporting the transaction
- Compare credit notes with previous ones processed by a suspected employee, especially if you are unfamiliar with the accounts of the customer.

Stock and equipment

Pilfering and theft are very common in most areas of business. Theft of inventory and small tools by employees for personal use or resale can add up to a large loss on the part of the company.

Action:

- Make use of closed-circuit television, or even fake cameras
- Remove keys from unattended equipment and put alarms on major pieces of equipment
- Light all storage areas
- Limit the number of entrances to the site
- Hire an external security company

Purchasing and payroll

As with the credit control department, there are opportunities for fraud within the department responsible for paying out money. For example:

- An employee invents a fake supplier and simply pays phoney invoices for an account which is, of course, his or her own. If questioned about the stock, he or she can claim that it is damaged, used up for being stored off-site
- In large companies, a person responsible for the payroll can invent fictitious employees, or intentionally fail to remove from the register a worker who has left the company, pocketing the unclaimed cheques.

Action:

- Review selected invoices to see whether they have been doctored
- Review supplier invoices for unusual amounts, pricing or volumes
- Observe payroll cheques distribution, monitoring unclaimed cheques

Preventing fraud with internal controls

Effective internal controls can drastically reduce the risk of fraud in your business, but every control will have an administrative cost. You will need to evaluate the cost of additional procedures against the financial risk of fraud. Fortunately there are some inexpensive measures that you can take immediately.

- **Separation of duties.** It is virtually inviting employees to commit fraud if you have the same person placing orders, running credit checks, delivering goods, preparing invoices, recording transactions and collecting debts. Wherever possible, you should separate or rotate duties among several employees.
- **Requiring purchase or payment authorisation.** Decide on a reasonable figure and ensure that single transactions above that amount require an authorisation, either from yourself or a trusted senior employee.
- **Comparing actual to budgeted expenditure.** The most frequent unauthorised transactions take place via expense accounts. By comparing your budget to the actual amounts being claimed by employees, you can identify discrepancies. These may be justifiable expenses, or they may be the tell-tale signs of inappropriate expenditure.

By focusing on the four areas we have covered - cheques, credit control, stock and equipment and purchasing and payroll - and by introducing internal controls, you will be able to minimise the risk of fraud to your business.

If you are looking for support and advice from a team of experienced payroll advisers, contact Firmvalue Payrolls.

Last updated in August 2020.