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Going Beyond Accounting, Taking Business Forward

The Reality of Employee Fraud and Theft in Small Businesses and how to Prevent It

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Compared to big business, employee fraud and theft is a serious threat to small businesses, particularly in this economic climate. Small businesses are especially vulnerable because they employ fewer people, are reluctant to hire outsourced professional accountants due to perceived high costs and lack fraud prevention know-how, resulting in reduced segregation of accounting duties and non-existent internal accounting and inventory controls.

The risk of employee theft and fraud, whether it entails inventory theft, theft of company cash, fabricating expense claims, or even stealing company time can be mitigated against if some of the following fundamental tips are implemented by the business owner:

1. Set clear values and standards

One of the best ways to help safeguard a business is to set clear standards and values from the beginning. This includes setting an appropriate example, starting from the top down.

2. Consider independent checks

All account reconciliations and general ledger balances should have an independent check by the business owner or a person removed from the day-to-day transactions, because theft often occurs when bookkeeping is sloppy, unsupervised and behind schedule.

3. Outsource a qualified accountant's services

If a business owner is not in a position to provide these level of checks, make sure your employees know that an external professional accountant has been hired on an outsourced basis to take on some of the independent checking function, or even provide all the required bookkeeping services. Make sure you are clear that an outsourced accountant or bookkeeper providing these services will not necessarily uncover fraud, but will enhance the control environment, possibly deterring fraudulent activities and benefiting the business owner on many other different levels. For example, professional accountants can review monthly financial results with the owner, helping to spot trends indicative of fraud or to find opportunities to improve profitability.

4. Implement internal controls

A good outsourced professional accountant can determine weaknesses within a business and recommend internal controls and procedures that ensure the efficiencies and effectiveness of operations, compliance with laws and the safeguarding of assets, such as cash and bank, debtors, inventory and fixed assets. Here are a few controls one might consider:

- **Segregation of duties**
  No single employee should be responsible for processing a transaction and banking or paying a transaction. For example, an employee who issues invoices to customers should not be responsible for taking or banking the cash from the customer. Even a small business can take steps to separate important functions.

- **Authorisation**
  Develop and implement policies to determine how financial transactions are initiated, authorised and recorded. For example, a credit note that needs to be issued to a customer for a return of goods or services can be initiated by an employee by completing a "goods received note", that is in turn authorised by the business owner or someone senior before handing to the bookkeeper for processing to the customer's account.

- **Make use of fraud proof accounting software**
  Be sure that accounting software does not allow for changes or manipulation to customer invoices and that the invoice is updated immediately to the customer account to record the transaction so as to prevent changes to the invoice later.

- **Access controls**
  Access to accounting records, accounting systems and financial assets, such as inventory store rooms should be restricted to authorised employees.

5. Check employee references

Pre-employment background checks are an excellent way to reduce the risk of hiring dishonest employees. A thorough pre-employment background check should include:

- Reference checks with all previous employers, not just the last one or two,
- Employment verification should include position held, length of employment, reason for leaving and salary earned.
- Education verification for degrees and diplomas
- Civil history for lawsuits involving debt collection, restraining orders, interdicts and fraud recovery.
- Criminal history for crimes involving violence, theft and fraud

6. Safeguard supplier payments

Segregated duties should go further to encompass payments to suppliers. The person reconciling the suppliers and preparing the supplier remittance advices should not record the suppliers in the books of account, nor be responsible for paying them. The business owner authorising the payments should only do so when they have the invoices and statement at hand to check who the invoice has been made out to and the payment amount loaded.

7. Safeguard payroll

Payroll is another area subject to fraud. Small business owners should take the extra time to review that every person has been correctly accounted for on the payroll, overtime and expense reimbursements are appropriately recorded and that the payment amount is right and that they personally authorise the bank payment. Although time consuming, this procedure provides a monitor to ensure employees are being paid appropriately. This can be especially important when a business has many subcontractors, temporary and part-time staff. Be mindful of "ghost employees" appearing on the payroll run if prepared by any other person other than the business owner. Open up a separate payroll current account with the bank to limit opportunity for payroll fraud.

8. Safeguard expense payments

As the business owner, ensure that before authorising expense payments loaded by your bookkeeper on electronic banking that you have all the relevant invoices to match to the payments. For example, when authorising payment for the telephone account, ensure that the name on the invoice is that of the business and that the account amount agrees to the invoice. This will ensure that an employee's own telephone account amount has not "slipped" into the amount payable.

9. Scrutinise your customer age analysis monthly

Long outstanding payments from customers can often indicate fraud whereby customers have paid, particularly COD customers, but have not been receipted as the money has not been banked into the business account, but into that of the employee!

10. Know your employees

Employees, including trusted long-term employees, often display behavioural traits that can indicate intention or actual fraud taking place. Be alert to key indicators of potential theft or fraud, such as:

- An employee never taking leave
- Apparent devotion to work and working late
- Strong objections to procedural changes related to financial, inventory or supply matters
- Strong objections to hiring an outsourced accountant
- Fabricating mistakes or faults of the outsourced accountant with the intention of having their services terminated

In many small businesses, the major reason trusted employees can commit their crimes is because management trusts them so much; they're family members or longtime friends, or they have proven work records and years of service.

That high trust level enables these employees to hide their activities. Even when business owners find suspicious behaviour, they often believe it's inconceivable that employees would violate these trusted relationships. So, consequently, they hesitate to investigate, which results in much larger frauds and severe cash flow problems that can lead to a small business's insolvency.

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