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A Dozen Ideas for Small Business Fraud Prevention

Any discussion of fraud can be a difficult one because most individuals value being a trusted member of any organization and, in most cases, key employees are trustworthy. Unfortunately, for any number of reasons, fraud in small businesses or small organizations does happen, can involve significant sums, and does cause damage to the organization and its people.

The theme of these recommendations is that it is appropriate to trust people, but it is also reasonable to verify that proper procedures are being followed and assets are safeguarded.

Many businesses and organizations, by necessity, rely heavily on small accounting staffs, where one trusted employee has access to the bulk of the accounting records, makes deposits, drafts and perhaps even signs checks, and makes journal entries. This "concentration of duties" creates internal control difficulties for such businesses as the only true "check and balance" is the routine involvement and review of the owner/manager.

To help with this situation, we have proposed a dozen relatively easy and simple suggestions to provide some level of oversight for your business or organization. This list is by no means all-inclusive or sophisticated. It is not intended to cover all areas of exposure to loss, or to be applicable to everyone. This list should be considered only as a starting point to offer reasonable oversight suggestions.

While there is no absolutely secure system of internal controls to protect against fraud, it is important for every business owner to create, to the extent possible, a business culture that discourages fraud. Any person may be susceptible to temptation or financial pressure. The goal is to create an environment in which, even if tempted, the individual believes that there is a strong chance of getting caught. This deterrent, we believe, constitutes valuable protection for the assets of your business or organization. Here is a listing of a dozen simple ideas to consider that may assist you in the prevention of fraud in your organization:

1) Bank Statements Review

A large amount of fraud is affected through fraudulent checks. Either checks are altered or drafted to pay personal expenses, to a fictitious vendor, or to the perpetrator.

Our recommendation is to have all paper bank statements (with cleared check copies) sent directly to the business owner. Alternatively, if electronic banking is used, the owner should gain access to "online" review of check disbursement payee listings. The owner should also view signatures and question any unusual wire transfers or checks or checks where the payee or amount seems incorrect. Banks vary on how the cancelled check copies can be obtained or viewed. Have a conversation with your banker. It is a good practice to ask for documentation for a small number of items each month. Review deposits for reasonableness and frequency. The owner should document their review by making note on the statement and initialing the face of the statement or any reports printed. This simple review, if done consistently, will provide at least some protection against disbursement fraud. Many fraud losses would have been avoided or discovered quickly if this practice had been employed by the business owner.

2) Vendor Records

The business owner should consider requiring approval of all new vendors to be added to the accounts payable system. In addition, one should randomly ask for vendor reports, which list amounts paid to each vendor to be printed in your presence from the system. Have the reports printed directly from the accounting software in your presence, to prevent editing or revisions. This practice may uncover fictitious or fraudulent vendors. Question any vendor name or vendor volume that looks unusual.

3) Cash/Check Deposits

Whenever possible, have the person opening mail and handling funds to be deposited be independent of the individual maintaining the accounting records. Ideally, the person posting customer checks into your system should be doing so based on check copies or a deposit slip listing. In smaller businesses, the owner may be the best person to receive and deposit checks and provide the listing to the accounting staff. If the owner is not making the deposits, look at the deposit slip details on a test basis to determine that all funds received are being deposited. Deposits should be made the same day that funds are received.

4) Signature Authority

Ideally, the owner should secure unused checks, sign all checks, and avoid, if possible, the use of signature stamps, as anyone who can obtain access to the stamp and a blank check can potentially disburse business funds.

5) Payroll

At a minimum, owners should carefully review the year-end W-2 forms (and 1099 forms) for reasonableness. Do compensation totals look reasonable? During the year, randomly review a detail payroll listing or two for reasonableness. Do you recognize all of the employee names? If not, consult another management person independent of payroll preparation. What you are looking for are inappropriate salary levels, or fictitious employees.

6) Credit Memos

All credit memos over a certain level should be appropriately approved as well as any account write-offs. Such approval should be documented. This may protect against misappropriation of customer payments on accounts receivable.

7) QuickBooks Audit Trail

QuickBooks (and other software packages) can produce an audit trail report, which lists any changes or overrides to the system. For example, one common fraud technique is to change the check payee in the system to cover up a check written to an inappropriate person. This audit trail report will highlight this type of change. It is very important to also review all non-routine journal entries. Ask for backup information and purpose of selected entries.

8) Credit Cards/Expense Reports

Full documentation of credit card charges and expense reports should be required and approved by an independent 2nd party before payment.

9) Monthly Operating Statements

The owner should require and promptly review monthly financial statements and compare with prior year, budgets, and/or expectations. It is a good practice to investigate any significant amount that differs from your expectations. It is also advisable to ask for and review the general ledger detail to look at year-to-date activity for certain accounts. Are there any entries that reduce revenue that are not expected? Sometimes fraudulent entries are hidden in high activity expense accounts.

10) Vacations

Require that all accounting staff take vacations and, if possible, plan for reassignment of duties during their absence. Where possible, cross training and rotation of duties are beneficial to any organization.

11) Reference Check/Insurance

Prevention is the best medicine. Reference and background checks should be performed before anyone is hired for a financial or accounting position. The company should also strongly consider an appropriate level of employee dishonesty coverage as part of its insurance policy coverage.

12) Tone at the Top

The owner/manager should at all times set the highest example of integrity in their business dealings. Employees can more easily rationalize breaking the rules if they perceive that the owner or manager does not consistently abide by or care about such rules. The owner should encourage all employees to come forward if any circumstances look unusual or improper to them, or any policies are not followed. This message should be in writing and reinforced by open discussions with your staff.

At Hantzmon Wiebel, we welcome the opportunity to discuss these suggestions in more detail with you to determine how each one may be applicable to your specific situation. In addition, there may be other measures that could further protect your organization against fraud. We can also help you explain these issues to your staff and assist in implementation.

Don’t wait for fraud to impact your business or organization! Contact us today at 434.296.2156.

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