



Small Business Fraud Prevention

Julie Aydlott, CFE



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First Printing – February 2010

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Published by: SDBAS Publishing

P.O. Box 7275

Loveland, CO 80537

970-776-8395

Fax: 970-692-2492

www.sdbas.biz

ISBN 978-0-9794124-1-7

Printed in the United States

In partnering agreement with
Business Fraud Prevention, LLC
Loveland, CO 80537

info@businessfraudprevention.org
www.businessfraudprevention.org

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Small Business Fraud Prevention Workbook

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Fraud Statistics

The following fraud statistics were presented by the Association of Certified Fraud Examiners (ACFE) in their *2008 Report to the Nation on Occupational Fraud and Abuse*¹:

- It is estimated that US organizations lose 7% of annual revenue to fraud.
- This loss totals roughly \$994 billion dollars and counting.
- Occupational fraud schemes frequently continue for years before they are detected.
- Financial Statement fraud was the most costly, with a median loss of \$2 million.
- Small Businesses were the leader of occupational fraud frequency in the 2006 and the 2008 Report to the Nation Study with ***almost 40% compared to large corporations, government and non-profits.***
- **The median loss from fraud for small business with 100 employees or fewer was \$200,000.**
- Anti-Fraud controls have a measurable impact on a company's exposure to fraud.
- Lack of adequate internal controls was the most common factor which allowed fraud to occur.
- It is estimated that 78% of victim organizations modified or implemented new internal controls after discovering that fraud had occurred.
- Occupational frauds were most commonly committed by management or the accounting department.

Based upon the staggering numbers, it is apparent that there needs to be a fraud-prevention method provided to the small business owner who can't afford the high accounting fees that a public company can pay. Although there has been an increase in anti-fraud controls, they tend to focus on public companies, government agencies and non-profit companies.

¹ The Association of Certified Fraud Examiners (ACFE) is the world's largest anti-fraud organization and premier provider of anti-fraud training and education. The entire Report can be downloaded at no charge from the ACFE's website: www.acfe.com

The small business owner tends to fall victim to occupational fraud more often, due to several factors. The owner . . .

- Cannot afford to hire additional staff to implement segregation of duties.
- Does not put an appropriate pay scale value on bookkeeping and accounting work and tries to fit it into their budget, which gives them under-qualified employees.
- Does not have the time AND does not make the time to review records.
- Does not think that a fraudster could possibly look like their bookkeeper.
- Has bad work ethics themselves.
- Avoids the warning signs.
- In addition, employees know there is too much freedom and feel confident that they can get away with fraud.

This workbook was created to outline a simple system of internal controls that you can implement in your own small business. As the presenter, I do not recommend that you send your secretary or your bookkeeper or even your right-hand man. If you own the business, own up to protecting your assets. Why would you send the bank robber to withdraw funds from your account? Not all employees are thieves, and not all perfect bookkeepers are perfect. I have researched and interviewed highly qualified Certified Fraud Examiners and Accountants on additional internal control procedures that the small business owner can utilize; yet I am constantly coming to the same conclusion.

My conclusion is that **YOU are the missing link in the segregation of duties**. Every article I read that has to do with small business fraud, and every new small business fraud case that is opened, has the same ingredients: missing internal controls; no segregation of duties; and a bookkeeper with too much accounting authority who can take advantage of the weakness within your company. It's time that you take the risks seriously and pencil yourself into the accounting equation to double-check, review and understand your books.

Your CPA provides a service for preparing your financial reports, tax returns and assisting you with accounting matters; however, your CPA isn't required to analyze your numbers and reports to see if fraud has occurred. When you are only dealing with preparing a tax return at the end of the year because you don't have the budget to pay for monthly financial reporting, your CPA is not responsible for digging deeper into your financial story. That is an extra cost per hour. If there is a noticeable deviation from

- Having complete register documentation and timely delivery of cash
- Communicating and adhering to the company policy

Internal Control Procedures for Small Businesses

Internal Controls have two separate elements.

- Structure
 - Which specific policies and procedures are designed to provide the company management with a reasonable assurance that the goals and objectives it believes are important will be met?
- Weakness
 - Is the weakness in the control environment, accounting or bookkeeping system, or the control activities or procedures?

In order to create a good internal control for your company, it is important that you follow and maintain certain steps.

- Implementing internal controls
- Following your procedures
- Reviewing your controls
- Setting ethical standards

Internal Control Procedures

The following internal control procedures are simple procedures which even the small business owner can implement. The biggest missing element is segregation of duties when there is only one person handling all of the bookkeeping functions in a small business. In order to combat this problem, the owner of the small business needs to involve themselves in the internal controls. If that is not an option, hiring an outside firm to monitor the company's assets is the next step.

- ***Know your employees***
 - By obtaining background checks
 - By checking references
 - Request employee be bonded
 - Be involved and actively supervise
 - Always spot-check your accounting records
- ***Bank Reconciliations***
 - Carefully scan the bank statements

in materials ($\$438,409 \times 14\% = \$61,377$) for the brother's fraud scheme. Nice brother! In the year 2000, which is not shown in this example, the average cost of goods was at 26%, which is consistent with 2002.

How can you tell the difference between bad accounting and fraud?

In about 90% of the internal control audits that I personally complete, I find that the business had very poor accounting records, and under-qualified bookkeepers. They also had owners who used the business accounts for personal use. It is incredibly important to make sure your own business accounting is completely separate from your personal accounting. Not only does it become costly to audit, it gives the bookkeeper all the more reason to feel entitled to use the business funds as well. Some of the differences between accounting incompetence and fraud are listed below.

Accounting Incompetence

- Messy accounting and filing
- Poor reporting habits
- Poor training
- Remorseful behavior

Malicious Fraud

- Deliberate
- Unusual entries and paperwork
- Change in behavior
- Resentful and or revengeful behavior

Legal Elements

If you end up with a deer-in-the-headlights look after you find out that fraud has occurred in your business, you need to be aware of the cost, possible outcome and financial impact that employee theft will have on your business. At this point when the dollar signs keep adding up, would it have been more cost-effective to take 4 hours a month to review your accounting, or pay an outside fraud prevention firm every quarter to review your accounting?

- If you suspect fraud don't jump the gun
- Costly mistakes could throw a case in a losing direction

**SMALL BUSINESS FRAUD ASSESSMENT
INTERNAL CONTROL QUESTIONNAIRE**

Download your risk assessment form at www.businessfraudprevention.org/forms.html

Owner:	Date:
Discussed with:	

Question	Yes	No	N/A	Comments
Employee and HR Assessment				
1. Did you complete a background check including credit check?				
2. Did you call on employee's references?				
3. Do you have an employee handbook?				
4. Does it include a written fraud policy and procedure?				
5. Is there a written job description?				
6. Do you make yourself available to employees, vendors and customers for complaints?				
7. Do you experience high employee turnover?				
8. Do any employees appear to have personal problems? Gambling / Debt / Pressure / Drugs / Divorce?				
9. Do employees take annual vacations?				
10. Do employees have an unrealistic productivity requirement?				
11. Do employees receive positive feedback and rewards?				
12. Does any employee seem to be living beyond their means?				
13. Do any employees work directly with friends or family?				
Skimming & Cash Larceny Schemes				
1. Do you periodically review sales for accuracy?				
2. Do you confirm inventory balances with physical counts?				
3. How often?				

Question	Yes	No	N/A	Comments
4. Do you authorize bad debt write-offs?				
5. Does your bookkeeper handle collections?				
6. Do you play a role in collections?				
7. Do you receive cash receipts and compare with actual deposits?				
8. Do you send out monthly accounts receivable statements?				
9. Does the bookkeeper immediately log in all incoming cash and checks to make the deposit?				
10. Do you review the deposit slip for accuracy?				
11. Are the deposits made daily?				
12. Are cash register amounts reconciled to the drawer daily?				
13. Do you have security cameras in cash areas?				
14. Do you periodically do surprise cash counts?				
15. Do you review journal entries to cash accounts?				
16. Do you use POS Software?				
17. Does your POS or accounting software track inventory?				
Check Tampering Scheme				
1. Are blank checks stored securely?				
2. Does your bookkeeper pay bills electronically?				
3. Does your bookkeeper sign checks?				
4. Are checks signed and mailed immediately?				
5. Do you review vendor statements for late fees and invoices due?				
6. Do you review the checks with the bills as you sign them?				
7. Are bank reconciliations completed immediately upon receipt?				
8. Do you review bank statements and canceled checks?				

BUSINESS FRAUD PREVENTION.ORG

Download this free form to modify for your business at www.businessfraudprevention.org/forms.html

Internal Control Program

01/01/2010

BUSINESS FRAUD PREVENTION, LLC

Internal Control Program TEMPLATE

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Payroll and HR

Business Fraud Prevention, LLC has implemented the following internal control procedures in the Payroll and Human Resources Department.

- Background checks are required on all new employees.
- References must be contacted before hiring.
- Written job description per job classification.
- Employee handbook must be written and up-to-date and should include:
 - Probation policy
 - Job rotation requirements
 - Privacy and access to company assets
 - Employee cooperation regarding procedures
 - Open-ended authorization to pull credit and background check
 - Consequences of fraud or theft
 - Employee must sign document stating that they have read and understand company procedures and requirements.
- Employee / Vendor / Customer hotline – or a confidential e-mail address for complaints or tips.
- Mandatory vacations
- Reward and positive feedback program
- Friends or family member working with company is by approval with the owner only.
- Conflicts of interest must be brought to the attention of the owner immediately.
- Payroll hours must be authorized by a supervisor and reviewed by the owner.
- Payroll checks must be signed by the owner – if outside payroll service is used do not authorize a signature stamp.
- Owner must approve all raises and overtime.
- Employee register must be reviewed for new hires, addresses and changes monthly.
- Owner must periodically review employee files.
- Owner must get to know all employees.
- Timecards must be verified for accuracy.
- Commissions must be compared to sales reports before payroll is issued
- Delivery of payroll checks must be watched closely.

Additional resources and statistics used for this workbook

ACFE Fraud Magazine (www-fraud-magazine.com)

www.acfe.com

ACFE 2006 Report to the Nation

ACFE 2008 Report to the Nation

Fraud Resources

Fraud resources and spam laws - <http://www.spamlaws.com/>

US Department of Health & Human Services - <http://oig.hhs.gov/fraud.asp>

Internet Crime Complaint Center- <http://www.ic3.gov>

Federal Bureau of Investigation - <http://www.fbi.gov>

National White Collar Crime Center - <http://www.nw3c.org>

Bureau of Justice Assistance - <http://www.ojp.usdoj.gov/BJA>

Consumer.Gov Identity Theft - <http://www.consumer.gov>

Equifax 800-525-6285 or 888-766-0008 - <http://www.equifax.com>

Trans Union 800-680-7289 - <http://www.transunion.com>

Experian 888-397-3742 - <http://www.experian.com>

www.safeguardID.com

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