



Top 7 Internal Controls to Prevent Fraud



While most employees are honest and reliable, there is no way to ensure that 100% of the people you hire fall into this category. Unfortunately, if one (or more) dishonest employees has access to your accounting systems or payroll, they can quickly wreak havoc on your business finances.

Though all companies will likely experience fraud at some point, small businesses are more susceptible. According to the most recent Global Fraud Study by the ACFE (Association of Certified Fraud Examiners), small businesses averaged a \$200,000 loss per fraudulent scheme. That's almost double the \$104,000 average loss of larger companies, which is already a significant figure.

Because fraud is so prevalent in the corporate world, it's difficult to avoid entirely. However, there are some types of fraud that are much more costly than others. These schemes are generally classified as payroll or accounting fraud. Thankfully, there are many ways you can help protect yourself from an expensive business loss. Here are the best methods for preventing payroll and accounting fraud.





#1 Divide Responsibilities Between Employees

Many business owners make the mistake of assigning one employee to perform all aspects of payroll and/or bookkeeping. This is almost always a bad idea. While some companies simply aren't large enough to warrant a full accounting department, you should never let one employee handle an accounting task from beginning to end. For example, if the employee approves invoices for payment, they shouldn't also process payments or sign checks.

Separation of responsibilities is crucial for many reasons. For one, it curbs opportunities for fraud, but it's also a great way to catch mistakes and hold employees accountable. If your company isn't large enough to employ multiple accountants or payroll clerks, you can handle some of the responsibilities yourself to help keep an eye on things. For example, you could approve invoices and sign checks, while your bookkeeper simply processes invoices for payment. As an alternative, many companies hire a third-party accounting or payroll firm to perform some of these tasks as well.





#2 Require Cross Training

Cross-training is a simple process that can save you lots of time and money down the road. With cross-training, you ensure that more than one employee knows how to perform all the duties and responsibilities of a position. Using this method, if one employee is out sick or on vacation, you have another person who can pick up the slack. Of course, this method also doubles as fraud prevention. It's never a good idea to put all the responsibility and knowledge of your accounting or payroll processes with one employee. This level of independence is often too tempting and leads to multiple opportunities for fraud.



#3 Mandate Vacation Time

By the same token, it's a good idea to insist that all employees take occasional vacation or personal leave. If an employee refuses to leave their work to someone else for a few days, they may be attempting to hide fraudulent activity or negligence.

When an employee does take time off work, make sure someone else picks up their responsibilities while they're gone. This helps work run smoothly, but it also allows the opportunity to catch any errors or suspicious activity.



#4 Conduct Periodic Third- Party Reviews or Audits

Some companies choose to employ an internal audit department to perform periodic audits or financial reviews. However, smaller companies usually cannot afford this luxury. Instead, you can hire a third-party CPA firm to perform these services. Just make sure you hire a professional who is trained to spot accounting and payroll errors or possible fraudulent activity.

At the least, you should conduct these reviews or audits annually, but quarterly or monthly is best for catching fraudulent activity quickly.



#5 Clearly Outline Job Processes and Review Regularly

Each position within your company should have clearly defined duties. For each responsibility, there should also be an outlined process. For example, an accounts payable clerk may be responsible for processing vendor payments. But how often should this occur? What are the steps required to approve invoices? Does your company take advantage of early payment discounts? These are all questions that should be answered within the outlined job processes. By regularly reviewing these processes, you help ensure that employees know and meet your expectations. More importantly, however, you leave little room for interpretation or independent decision-making, which often leads to fraudulent activity.



#6 Educate Employees

As with most things in life, knowledge is power when it comes to fraud. Your employees are your best line of defense when it comes to detecting internal fraud – if they know what to do. First, make sure you have a clear code of conduct and that all employees read and understand it thoroughly. You can also provide fraud training to help employees know the most common types of fraud as well as the ways to spot suspicious activity. Finally, many companies find success with an anonymous tip process, including a rewards system for reporting fraudulent activity.

Remember: Tips account for 40% of fraud detection, and over half of those tips come directly from employees.



#7 Prosecute Fraud Whenever It Occurs

Finally, and perhaps most importantly, you should always prosecute fraud whenever it does happen. Too many companies fail to enact disciplinary and/or pursue legal consequences when fraudulent activity is detected.

This may be for a variety of reasons. They may assume disciplinary measures will be too costly, or that the cost of the fraud isn't "worth the trouble." But companies that fail to prosecute culprits are sending a message to other employees as well. If there are no consequences to their actions, why should employees remain honest and ethical?



Final Thoughts

Though fraudulent schemes are costly and pervasive, companies are far from helpless when it comes to preventing and detecting this type of criminal activity. By implementing the internal controls outlined above, you can stay vigilant and fight back against employee fraud. If you need any assistance or have further questions about payroll and accounting fraud, please contact our office. One of our accounting professionals will be happy to assist you with your efforts.



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