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Fraud and How to Spot It - Ten Step Guide

Major corporate frauds and collapses hit the headlines from time to time and many of these were high profile and the amounts involved quite spectacular.

With the current pressures we are still facing from a slow economy, challenges associated with difficulties in renewing finance, the challenge of achieving targets, even simply paying suppliers bills and it becomes easy to see that the risk of fraud for all sizes of businesses has increased significantly.

The issues associated with well publicised frauds may seem far removed from your business but the simple truth is that fraud can affect businesses of all sizes. Whether you employ a small team or a significant workforce, this factsheet considers how you can increase your awareness of the factors that indicate fraud. It also sets out the defences that you can implement to minimise the risk within your business.

It couldn't happen here

It is easy to think that fraud is something that 'couldn't or wouldn't happen here'. However while large businesses have the resources to implement what they hope are effective systems of internal control to prevent fraud, smaller and medium-sized businesses often have to rely on a small team of people who they trust. No doubt you can think of a handful of key employees who you couldn't imagine being without! On so many occasions employers have said "do you know he/she (the fraudster) was my most trusted employee".

A key difficulty faced by smaller businesses is the lack of options to segregate duties. Individuals have to fulfil a number of roles and this can lead to increased opportunity and scope to commit fraud, and for some, the temptation can be too great.

Areas where fraud can occur

While the precise nature of any fraud will be specific to the nature of the business and the opportunities afforded to a potential fraudster, there are a number of common areas where fraud can occur.

Employees abusing their position

Most fraud impacts on the profit and loss account, where either expenses are overstated or income understated. Frauds here could range from a few pounds of fiddled expenses, where no one checks supporting documentation or reviews whether the claim made is reasonable, to more significant frauds. These could involve the setting up of fictitious suppliers and the production of bogus invoices, or an employee who approves purchases working in collusion with a supplier.

Positions could also be abused where a business requests tenders. Here there is a risk of 'kickbacks' where the individuals involved in the tender process accept bribes or sweeteners from potential suppliers. This could result in inefficient contracts being signed perhaps for dubious quality goods.

The individual amounts involved in these types of fraud may not be large, so they go unnoticed for some time. However as time progresses the amounts involved can become significant. Many fraudsters gain in confidence and the figures involved escalate as they become 'greedy'. Of course large scale frauds are more likely to be discovered and greed often plays a part in the identification and capture of fraudsters.

Nevertheless the time taken to detect fraud is vital. It may make all the difference to cashflow as fraud drains a business of resources that it needs to grow.

Suppliers taking advantage

Where a business has few or weak checking procedures and controls, a supplier may recognise this fact and take advantage. For example fewer items may actually be delivered than those included on the delivery note. Invoices may include higher quantities or prices than those delivered and agreed.

This highlights the importance of checking both delivery notes and invoices and following up any discrepancies promptly.

Other risk areas

Theft of confidential information such as client or customer lists or intellectual property such as an industrial process could cause a business untold problems if these are stolen by disgruntled employees. There have even been examples of these being copied onto a smart phone!

Information could also be vulnerable to attack from outside. Advances in technological developments mean that businesses need to consider IT related risks. Nowadays it is often believed that the computer is always right, so fewer manual checks are completed generally within the organisation as a result.

Certain types of organisation are at greater risk of fraud, for example those that are cash based can be more vulnerable due to the difficulties in implementing effective controls over cash. Similarly businesses that deal in attractive consumer goods are at increased risk.

Examples

J F Bogus & Sons

You might think that this could never happen to you but if your trusted bookkeeper presents you with an invoice and a cheque to sign, just how hard do you look at the invoice? The amount might be relatively small and is of course supported by an invoice. You have to sign the cheque in a hurry as you won't be in tomorrow and it's 5.15pm. Your bookkeeper will fill the payee line in before the cheque is sent out.

Ultimately, your year end figures just don't look quite right and subsequent investigations identify missing invoices and eventually, that the bookkeeper has been making these cheques payable to himself.

Sporting life!

Stock controls were put to the test in the sportswear and equipment business that showed up too many discrepancies between computerised stock and that actually counted at the year end. The differences could not be explained and eventually surveillance was used to monitor the warehouse.

Revealing footage showed the cleaners adding various bats, balls and kit to the bin bags full of rubbish removed each evening!

Businesses that are growing rapidly may also be more susceptible to fraud. When both company resources and directors personally are stretched to capacity, it is even more difficult to maintain an overview. Indicators of fraud may go unnoticed.

Does anyone know where Sid is?

Imagine the surprise a director of a local manufacturing company had when he handed out the payslips to his workforce and two were left over! His financial controller, who had never missed handing these out previously, had been taken ill and could not come into work. Subsequent investigations revealed that for some time, this much trusted staff member had created fictitious employees and had been paying the wages into his own bank account.

Ten step guide to preventing and detecting fraud

Given the wide range of fraud that could be committed, what steps can you take to minimise the risk of fraud being perpetrated within your organisation? Consider our top ten tips for detecting and preventing fraud.

1. Begin by recruiting the right people to work in your organisation. Make sure that you check out references properly and ensure that any temporary staff are also vetted, particularly if they are to work in key areas.
2. Ensure that you have a clear policy that fraud will not be tolerated within the organisation and ensure that this is communicated to all staff.
3. Consider which areas of your organisation could be at risk, then plan and implement appropriate defences. Target the areas where most of your revenue comes from and where most of your costs lie. Develop some simple systems of internal control to defend these areas. Effective controls include:

   - segregating duties
   - supervision and review
   - arithmetical checks
   - accounting comparisons
   - authorisation and approval
   - physical controls and counts

4. Wherever possible don't have only one person who is responsible for controlling an entire area of the business. This in particular includes the accounting function but will also include other key areas. For example ordering goods, stock control and despatch in a business where stocks include attractive consumer goods.
5. Always retain a degree of control over the key accounting functions of your business. Don't pre-sign blank cheques other than in exceptional circumstances and ensure that the corresponding invoices are presented with the cheques.
6. Be on the lookout for unusual requests from staff involved in the accounting function.
7. Watch out for employees who are overly protective of their role - they may have something to hide. Similarly watch out for disaffected employees, who might be bearing a grudge or those whose circumstances change for the worse or inexplicably for the better!
8. Watch out for notable changes in cashflow when an employee is away from the office, on holiday for example. Similarly be aware of employees who never take their holiday. These could both be indicators of fraud, something we see when we look back retrospectively.
9. Prepare budgets and monthly management accounts and compare these against your actual results so that you are aware of variances. Taking prompt investigative action where variances arise could make all the difference by closing the window of opportunity afforded to fraudsters.

10. Where a fraudster is caught, make sure that appropriate action is taken and learn from the experience.

Winning the battle against fraud

While the most devious of fraudsters might go unnoticed for some time, many fraudsters are ordinary individuals who see an opportunity. The frauds that they commit are quite simple in nature.

The implementation of some simple checks within a business can make it much more difficult for a fraudster to take advantage. The results could be startling - preventing a fraud of £100 each week equates to around £5,000 leaving a business over a year. Operating at a 20% margin would mean generating £25,000 of turnover to compensate for this.

How we can help

If you would like to discuss any of the issues raised in this factsheet please do contact us.

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