

FAQs: Common Fraud Risks And Prevention Tips

It is commonly said that to fix a problem, one first needs to identify there is a problem. Fraud, in its various forms, is a problem that can deplete valuable resources, decrease organizational morale, and damage an organization's public perception. Therefore, it is important organizations take a proactive approach to mitigating employee fraud risks. To put employee fraud risk into context, consider the following facts from the Association of Certified Fraud Examiners (ACFE):

- Organizations lose approximately 5% of their revenue to employee fraud and occupational abuse each year.
- U.S. businesses lose up to \$110 million per day due to employee-related crimes.¹

Unfortunately, when it comes to potential fraud, small businesses, non-profits, and governmental organizations frequently fail to recognize and act on weaknesses in their control structures until after a fraud event occurs. The objectives of this article are to answer common questions regarding fraud risks and offer common-sense mitigation techniques.

Why does employee fraud happen?

If fraudulent activity is suspected, employees in financial service positions, such as chief financial officers, accountants, and bookkeepers, may be good individuals to start with in an investigation due to the nature of their roles. According to the National Association of Certified Valuators and Analysts, four common factors create the ideal circumstances for fraud²:

1. **Opportunity** – inadequate internal controls provide the perfect opportunity for fraud.
2. **Rationalization** – fraudsters create justifications to rationalize their actions.
3. **Pressure** – external pressures, such as significant personal debt or credit problems can tempt someone to commit fraud.



4. **Capability** – to successfully pull off a scheme, the employee has to have the patience, access, and knowledge to succeed.

Are there common traits of employees who defraud their employers?

While there is no single, foolproof characteristic in identifying a potential fraudster, there are common red flags that have proven helpful in earlier detection of fraud, such as:

- An employee's lifestyle suddenly does not match their salary. When an employee is suddenly living well beyond their means, that could be a sign of potential fraud.
- An employee is acting unusually secretive. If an employee is reluctant to share their work processes, or have someone review their work, it could be a sign of potential fraud.
- Other employees have expressed concerns about an employee. According to the ACFE, 42% of employee fraud cases are detected from tips².

What are common types of employee fraud?

Employee fraud is a widespread problem that costs U.S. businesses approximately \$50 billion per year. It is especially damaging when the fraud involves upper-level management. Employee fraud takes many different forms, including³:

- **Asset misappropriation** – the unauthorized use of company assets for personal gain.
- **Vendor fraud** – this occurs when a vendor and/or employee scam their company using vendor payments (e.g., overcharges, duplicate payments, or creating fake vendors).
- **Payroll fraud** – includes faking work hours, inflating pay rates, collecting pay advances without repayment, or collecting pay for non-existent workers.

How prevalent are employee fraud schemes?

The scope of employee theft and position abuse cannot be understated. From timecard manipulation to stealing an organization's money or information, there are many ways for an employee to harm their employer. While some of these acts may seem minor, it is important to understand the cumulative impact of even seemingly small frauds:

- In 2020, asset misappropriation was the most common scheme used to defraud employers and appeared in 86% of the cases examined globally.
- Time theft schemes affect approximately 75% of all U.S.-based organizations and costs can be as high as 7% of an organization's gross annual payroll.
- Employee theft prosecution data shows that typically 14 months go by between the time a fraud scheme begins and when it is detected.

I see fraud risk is real for all types and sizes of organizations. What are straightforward approaches to mitigate risk?

The best starting point for fraud risk mitigation is the culture set by the organization's management and leadership. Some examples of a strong organizational culture and effective internal controls are:

- **Hiring the right employees** – screen potential employees thoroughly, checking past employment, personal and professional references, and criminal records. This is especially important if the person will handle cash, inventory, or other assets of the organization.
- **Separate accounting duties** – many small organizations depend on one person to handle most of the

accounting tasks, such as opening mail, processing payments, making bank deposits, paying invoices, and reconciling bank statements. It is advised to divide accounting responsibilities so no single individual controls all of the financial activities. For instance, the person who makes deposits or writes checks should not also reconcile bank statements.

- **Arrange for surprise internal audits** – catching an employee off-guard can be a good defense in uncovering fraud. The fact that an organization implements surprise audits can act as an effective fraud deterrent.
- **Open lines of communication with employees** – provide employees with a means of reporting suspicious activity. Fraud schemes are frequently exposed because of the employee tips.
- **Insist that all employees take allotted vacation time** – employees who are committing fraud often resist taking vacation because they must remain on the job to cover up their fraudulent activity. In fact, they can often appear to be very diligent and loyal employees, working extra hours and taking on additional tasks. However, the true motivation behind the additional work is to conceal a fraud scheme.
- **Implement a fraud policy** – an effective policy should provide an explicit definition of actions that constitute fraud, state that fraud will be prosecuted, and provide employees with a framework for reporting suspected fraud.

While preventing fraud is a constant battle for many organizations, proactively implementing the proper internal controls and cultivating a culture of accountability can serve as effective fraud deterrents. Seeking the assistance of an internal control expert, or certified fraud examiner, to help structure your fraud defense plan and fraud policy can save time and money down the road. As the saying goes, "An ounce of prevention is worth a pound of cure." 🌿

Travis D. Walker, CPA, ABV®, is a shareholder with KPM CPAs & Advisors (KPM). He has more than 17 years of accounting experience and provides controllership and accounting outsourcing services to clients in a variety of industries.



In addition, he specializes in business valuations for tax, litigation, and mergers and acquisitions with an emphasis on litigation support. Travis is a member of the American Institute of CPAs (AICPA), Missouri Society of CPAs, and AICPA's Forensic and Valuation Services (FVS) Section. He graduated from Tabor College with his B.B.A. degree and Missouri State University with his M.B.A. degree. In addition to being a Certified Public Accountant, he holds the Accredited in Business Valuation® designation from the AICPA's FVS Section.



SGR JOB BOARD

- Advertise your job openings on the second largest local government job board in the nation with more than **1,600** local government job opportunities posted on any given day.
- Invest just **\$369** for unlimited job postings in a calendar year (less than the cost of one ad in most professional publications).
- Benefit from a job board that receives on average, **25K** page views per month

Visit the website or email
LoriPhilyaw@GovernmentResource.com

WWW.SGRJOBS.COM

MUNICIPAL ENGINEERING

Experienced In Civil Engineering Design Including Stormwater Management



CONSULTING ENGINEERS

Civil Engineering
Stormwater Management
Electrical Engineering
Structural Engineering
Utility Rate Analysis
GIS/Mapping
Grant Writing & Administration
Land Services



tothassociates.com
417.888.0645
1550 E. Republic Road
Springfield, MO 65804



OUR VISION IS STRONGER COMMUNITIES THROUGH RELIABLE ENGINEERING DESIGN

Michael A. Nelson, CPA, CFE, is a supervisor with KPM. He has more than eight years of accounting experience and provides tax services to clients in a variety of industries. He is a member of the American Institute of CPAs, Missouri Society of CPAs, and Association of Certified Fraud Examiners (ACFE). Mike also is involved in the community, serving as a volunteer for the Volunteer Income Tax Assistance Program, United Way of the Ozarks, and Ronald McDonald House Charities of the Ozarks. He graduated from Missouri State University with his B.S degree in Accounting, MAcc degree, and MBA degree. In addition to being a Certified Public Accountant, Mike is a Certified Fraud Examiner from the ACFE.



KPM CPAs & Advisors' (KPM) team of experienced forensic specialists can help you through a financial investigation if there is evidence of

wrongdoing. They analyze financial records, trace funds, find hidden assets and transactions, interview suspects and tally losses. Learn more at <https://www.kpmcpa.com>.

Endnotes:

¹30+ surprising employee theft statistics and facts (2022 edition). SmallBizGenius. (2022, March 25). Retrieved from <https://www.smallbizgenius.net/by-the-numbers/employee-theft-statistics/#gref>

²Signs of employee fraud. Business News Daily. (2022, June 29), from <https://www.businessnewsdaily.com/11164-how-to-spot-employee-fraud.html>

³Fraud Detection & Prevention for Financial Organizations: Ultimate guide - blog: UNIT21. Unit21. (2022, May 11). Retrieved from <https://www.unit21.ai/blog/fraud-detection-prevention-for-financial-organizations>

Our passion is creating
LASTING COMMUNITY ASSETS

and that is what motivates us
every day.

Community Planning, Economic
Development, & Urban Design in
St. Louis and around the country for
more than 50 years.

www.pgavplanners.com

