

Is something missing from your bottom line?

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We are all too familiar with the mega fraud scandals of Enron, Tyco, and WorldCom. And just about every day you can pick up any newspaper and read about how fraud happened in another company. But what about your company? Could it happen to you? The answer is YES. Virtually every business will be a victim at one time or another. And smaller businesses are more likely to be victimized than the largest companies. According to the Association of Certified Fraud Examiners' 2004 Report to the Nation, embezzlement and other forms of fraud occur at a higher rate in small businesses than in larger businesses. About 46% of fraud occurred in companies with less than 100 employees, whereas 30% occurred in public companies. The median loss experienced by small businesses was \$98,000. This was higher than the median loss by all but the very largest organizations. Small businesses are less likely to be able to survive such losses and should exercise greater caution and vigilance in protecting themselves.

Why Are Small Businesses At Higher Risk?
Two key reasons small businesses are more vulnerable to fraud, primarily embezzlement, are the lack of segregation of duties and a higher level of trust placed in employ-

ees. While it is important to cultivate a collegial working atmosphere, be careful not to create a breeding ground for fraud. While most of your employees are trustworthy, sometimes things happen to an otherwise honest person – family medical bills, personal debt, gambling losses, drug or alcohol addiction, loss of social status – and the thought of “I’ll just borrow it and return it later” creeps in. Given the right circumstances, some individuals may eventually act on that thought and your profits will begin to seep out the door.

How Can You Prevent It?

Embezzlement is a special type of fraud. It involves the violation of your trust and the misuse of company assets for one’s own personal gain. You trust your employees to pay the company bills, to properly account for inventory, or deposit customer receipts. But when an employee starts paying bills to a fictitious vendor, pilfering inventory, or skimming customer receipts, your trust is violated and your profits begin to dwindle. The best way to safeguard your company’s assets is to recognize and improve weaknesses in your internal control practices. It is also vital that you exercise management oversight.

What are Internal Controls?

Internal controls are the company’s policies and procedures that are designed to provide reasonable assurance that the company’s assets are safeguarded, the financial information is accurate and reliable, and that the company complies with laws and regulations. The success of any internal control system is in monitoring the controls to ensure they are working as intended.

The internal controls required by your business will depend on the type and size of the business. A retail store, for example, may focus its efforts on protecting inventory with security cameras and performing surprise inventory counts. A manufacturing company with many hourly employees might concentrate on preventing time card fraud by using a mechanical time stamp machine.

Regardless of your industry, you must protect your business. Part of the creed of the Association of Certified Fraud Examiners is, “Fraud is Easier to Prevent than to Detect.” A proactive approach to preventing fraud is a must in today’s business world. If you would like more information regarding proactive fraud controls for your business, please call Mary Ayers. She can be contacted at mea@nsbn.com or (310) 288-4294.

What Can You Do?

Doing the following can help reduce the incidence of fraud (this list is not all inclusive):

- Develop a fraud policy that outlines what actions you will take if an employee commits fraud. Be sure the policy is communicated to every employee.
- Conduct background checks on prospective employees. The background check should include screens for criminal records as well as financial problems.
- Perform regular cash reviews that reconcile receipts and disbursements.
- Regularly verify assets, including inventory and supplies.
- Never sign blank checks.
- Segregate duties; related duties should be assigned to different people.
- Rotate job duties periodically.
- Review and monitor employee computer access to financial and sensitive company information.
- Regularly review the vendor listing; i.e. know who your vendors are.
- Provide a hotline that can be used anonymously by employees, customers, or vendors to report suspicious or known fraudulent activities. Be sure to follow up on all allegations.
- Periodically the business owner should open and review the bank statements, checking the payees and endorsements.