

# Preventing fraud in small firms

BY DAVID RACHFORD

A bookkeeper in Santa Barbara was recently charged with embezzling \$1 million from her former employer. The absentee owners became suspicious because the business was incurring losses, yet was busier than ever. After conducting a review of the books, auditors became aware that fraud had occurred.

Most occupational fraud occurs in businesses with fewer than 100 employees, and results in a median loss of \$98,000. Small businesses are less likely to employ antifraud measures or be audited due to their size.

With tighter budgets and cash flow challenges, small business owners may think, "I can't afford to invest in internal controls." The truth is; with stakes this high, owners can't afford not to.

According to the Association for Certified Fraud Examiners in its "2004 Report to the Nation on Occupational Fraud and Abuse," fraud was responsible for an estimated \$761 million in losses.

Small businesses account for the majority of employers in the Tri-Counties. Strong small businesses are essential to the health of our community. Fraud can be devastating to a small business.

## MOST COMMON TYPES OF FRAUD

- **Skimming:** A clerk fails to record a sale and pockets the cash.
- **Fraudulent disbursements:** Payments are made against phony invoices.
- **Checkbook fraud:** One employee has control of the company checkbook, and there are no



safeguards in place.

- **Payroll fraud:** Filing for fake overtime, or for fake employees.
- **Inventory fraud:** It doesn't matter whether the items are small or large—inventory disappears.

## PREVENTING, DETECTING FRAUD

- Adequately prescreen employ-

ee applicants. Consider obtaining credit reports on employees that are being screened to work in financial areas.

- **Restrict bank account access,** especially ability to initiate wire transfers, and authorize electronic transactions.
- **Regularly review payroll records and registers.**
- **Secure inventory and supplies.** Perform regular counts and consider installing security monitoring.
- **Perform regular bank reconciliations.**
- **Give employees a way to report fraud.** Tips catch the majority of fraudsters.
- **Hire a certified public accountant to examine the books.** A regular checkup may help prevent a major disaster, or catch problems early.

If you think you might be the victim of fraud, don't hesitate to call the authorities. Although chances are slim that a recovery will be made, catching and prosecuting a perpetrator sends a strong message. As Al Capone said: "Punish one, teach a hundred."

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