By Michael E. Davis

In These Turbulent Times, Are You Protecting Your Small Business From Fraud?

As uncertainty in the economy persists, small businesses are feeling the strain of tough economic times. Unfortunately, this could place your business at even more risk from the damaging effects of fraud in the workplace. Like never before, small business owners need to be more diligent and thorough in protecting themselves and their companies. Implementing simple safeguards and communicating the importance of honest ethical standards within your small business can go a long way in mitigating fraud in the workplace.

Small businesses may be vulnerable to several types of fraud, including asset misappropriation and collusion. According to the Association of Certified Fraud Examiners (ACFE), occupational fraud occurs an average of 18 months before it is discovered. When thieves avoid detection, they are motivated to steal even more. In addition, the losses per employee from fraud in small businesses are 100 times greater than those at their largest counterparts.

Nine out of 10 occupational frauds involve a company's cash. Cash is vulnerable in three areas:

• skimming, which is stealing money from the company before it is received and recorded.

• larceny, which is the theft of cash after the company has received and recorded it.

• fraudulent disbursements, which includes paying false invoices, paying unauthorized vendors or employees, falsifying documents and unauthorized use of credit cards.

Business equipment, inventory and supplies also can be vulnerable. Laptop computers, software, electronic equipment, office supplies and inventory items, such as food, clothing and merchandise sometimes can be easy targets for misappropriation. Employees who steal usually opt for stealing something that is particularly useful to them personally or that can be easily sold or traded. Some questions business owners should ask themselves include:

• Are salespersons, purchasing agents or other employees receiving enticements from outside the company, e.g., free trips, kickbacks?

• Are employees trying to meet goals to receive a bonus?

• Are company assets being used for personal reasons? According to ACFE, there are three reasons small businesses are vulnerable to fraud: limited internal controls, too much

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trust, and inadequate employee prescreening. The foundation of fraud prevention is the segregation of duties between employees. The reason is straightforward enough: it is one thing to steal by yourself, but quite another to enlist the aid of a co-worker. Trust is an essential element of business, as well as an essential element of fraud. The goal is to strike a balance between the two. The thing to remember is that all fraud is done by those we trust and that trust is not a control. Employee prescreening is difficult. Former employers, because of potential liability, do not release enough meaningful information. However, you can request professional recommendations, check for criminal records and require drug screening. Business owners need to be aware of some of the common warning signs or red flags: rising expenses, declining revenue, a department is over budget, abnormally high inventory shrinkage, new or unfamiliar vendors, absenteeism, employees living beyond their means and/or demonstrating suspicious or inappropriate activities.

Small businesses, especially those that do not have regular audits, have every reason to worry about fraud. Most small businesses don't need a financial statement audit; however, CPAs can provide a number of fraud-prevention services, such as internal control reviews, design of internal controls, cash reviews and reconciliations, inventory observations and asset verifications. Fraud is a cost of doing business that is hidden from view. We know about fraud only when it is discovered. Completely eliminating the potential fraud is not possible, but with reasonable measures, its impact can be limited.

There are several ways small business owners can reduce the risk and help in the detection of fraud. Those include implementing an overall system of internal control and reviewing it frequently, restricting bank account access, performing regular bank reconciliations, separating duties among employees, rotating job responsibilities periodically, utilizing a company policy and procedure manual, adequately securing inventory and supplies, conducting surprise audits, performing thorough background checks before hiring, engaging a CPA to examine the books or perform an internal control review, and most importantly, giving your employees a safe and comfortable way to report fraud.

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